

March 2018

The Monthly

With this commentary, we plan to communicate with you every month about our thoughts on the markets, some snapshots of metrics, a section on behavioural investing, and finally an update on MacNicol & Associates Asset Management (MAAM). We hope you enjoy this information, and it allows you to better understand what we see going on in the market place.

“Someone is sitting in the shade today because someone planted a tree a long time ago.”

- Warren Buffett

The Numbers:

| <u>Index:</u> | <u>Year-to-Date:</u> | |
|---|----------------------|------------|
| S&P/TSX: | -4.52% | |
| NASDAQ: | +8.33% | |
| Dow Jones: | +0.33% | |
| S&P500: | +1.98% | |
| <u>Interest Rates:</u> | <u>Canada</u> | <u>USA</u> |
| 90-Day T-Bill: | 1.12% | 1.68% |
| 5-Year Bond: | 2.05% | 2.65% |
| 10-Year Bond: | 2.24% | 2.88% |
| 30-Year Bond: | 2.41% | 3.15% |
| <u>Economic Data:</u> | | |
| <ul style="list-style-type: none"> The Bank of Canada held on rates as concerns over NAFTA Reform shaped a more dovish tone. The US jobless rate remains unchanged at 4.1% for the fifth month in a row, with increases seen in wage growth. On the contrary that US housing is slowing down, the construction exceeded the 1.234million expectation with the US housing starts reporting 1.326million for the month of January. The wildly tracked US 10-year yield eased on a weaker auction of US treasuries | | |

Valuation Measures: S&P 500 Index

| <u>Valuation Measure</u> | <u>Latest</u> | <u>1-year ago</u> |
|--------------------------|---------------|-------------------|
| P/E: Price-to-Earnings | 22.8 | 21.5 |
| P/B: Price-to-Book | 3.1 | 2.9 |
| P/S: Price-to-Sales | 2.2 | 2.1 |
| Yield: Dividend Yield | 2.30% | 2.37% |

Year-to-date Performance, by Sector: March 8, 2018

| <u>U.S. Markets</u> | <u>Close</u> | <u>Net</u> | <u>1 Day%</u> | <u>YTD %</u> |
|--------------------------|--------------|------------|---------------|--------------|
| Dow Jones | 24801.36 | -82.76 | -0.33% | 0.33 |
| Dow Jones Transports | 10408.88 | -26.64 | -0.26% | -1.92 |
| Dow Jones Utilities | 664.80 | -4.88 | -0.73% | -8.10 |
| S&P 500 | 2726.80 | -1.32 | -0.05% | 1.99 |
| S&P 400 Midcap | 1920.42 | 3.43 | 0.18% | 1.04 |
| S&P 600 Smallcap | 956.49 | 6.66 | 0.70% | 2.16 |
| NASDAQ | 7396.65 | 24.64 | 0.33% | 7.15 |
| Russell 2000 (Smallcaps) | 1574.53 | 12.33 | 0.79% | 2.54 |
| BKX (Banking) | 113.77 | 0.00 | 0.00% | 6.61 |
| BTK (Biotech) | 4762.41 | 38.03 | 0.81% | 12.79 |
| XOI (Oil Index) | 1286.18 | -9.43 | -0.73% | -3.70 |
| SOXX (Semiconductor) | 1400.47 | 3.99 | 0.29% | 11.76 |
| XAU (Gold/Silver) | 78.79 | -2.01 | -2.48% | -7.60 |

Source: Jeffrey Saut, Raymond James

Anachronism

We are big fans of Warren Buffett. The “Oracle of Omaha” is widely regarded not only as an icon of American capitalism but as one of the greatest investors of all times. Nothing we say here at *The Monthly* or anywhere else for that matter will ever change Buffett’s “Oracleness”. Buffett’s legacy on the other hand is a matter we will speak more about shortly. For now, a subtle nuance from the most recent Berkshire Hathaway shareholders’ letter: its notable lack of nuance. Remember the Berkshire Hathaway shareholder’s letter is hands down one of the most widely read shareholders’ letters on the planet. And Buffett, its chief architect, is hands down one of the most widely followed investors on the planet. So why does Buffett read like he’s playing coy?



From Omaha, NE...

“Charlie and I view the marketable common stocks that Berkshire owns as interests in businesses, not as ticker symbols to be bought or sold based on their “chart” patterns, the “target” prices of analysts or the opinions of media pundits. Instead, we simply believe that if the businesses of the investees are successful (as we believe most will be) our investments will be successful as well. Sometimes the payoffs to us will be modest; occasionally the cash register will ring loudly. And sometimes I will make expensive mistakes. Overall – and over time – we should get decent results”.

- www.bershirehathaway.com/letters

We would not dream of disparaging an individual whose personal net worth dwarfs that of a good number of medium sized Canadian corporations. Although, we will politely point out that Buffett does not really offer any specific kernels of wisdom for investors to chew on in his recent communication. The above quote seems just as likely to grace the 2019, 2020 or well you get the idea editions of Berkshire’s annual shareholders’ letter. Buffett and Berkshire are conspicuously old fashioned and strangely out of place in a world where multi-million dollar transactions can be executed in seconds over a smart phone.

The question is, do investors refer to Buffett as the “Oracle” because he is like a priest whose letter is the prophecy investors use to position their own portfolios or because the letter is ambiguous and obscure? We personally don’t know but we think the answer may have something to do with interest rates.

Have a gander at “The Oracle’s” view on bonds...

“I want to quickly acknowledge that in any upcoming day, week or even year, stocks will be riskier – far riskier – than short-term U.S. bonds. As an investor’s investment horizon lengthens, however, a diversified portfolio of U.S. equities becomes progressively less risky than bonds, assuming that the stocks are purchased at a sensible multiple of earnings relative to then-prevailing interest rates. It is a terrible mistake for investors with long-term horizons – among them, pension funds, college endowments and savings-minded individuals – to measure their investment “risk” by their portfolio’s ratio of bonds to stocks. Often, high-grade bonds in an investment portfolio increase its risk”.

We hate to sound insolent but given the level of interest rates many investors have to contend with today, Buffett's view on the bond market is kind of intuitive at this juncture. Okay maybe not intuitive but light years away from profound. More importantly, we believe that as time soldiers forward, more and more of the attention given to Mr. Buffett as an investment legend will fall on that of his successor or successors. Buffett's heir(s) apparent will inherit the keys to a fabled firm with a storied past, at a time when super low interest rates rise and loose monetary policy fad to fiction. Also inherited will be some investments that are less like interests in business and more like concerns *about* businesses like money losing TEVA Pharmaceuticals which form 13F filings show Berkshire as owning 19 million shares of. True, a \$350 million bet [for Warren Buffett] isn't exactly tantamount to "betting the farm" on a horse. Though it doesn't help when the chief is visible out of the know about such investments. Mr. Buffett sat down with a reporter from CNBC shortly after the shareholders' letter was released and seemed totally unaware of the Teva trade. When pressed, Mr. Buffett responded that he was "not personally involved."

Hmmmm...

A giant of the investment world is plausibly just down the hallway from a team of junior deputies wagering \$350 million and he is "not personally involved" with the trade?

Buffett is also the person who disparages digital cryptocurrencies suggesting they are doomed at some point without saying when that will be or why the anti-fiat currencies will implode to begin with.

But let us return to the matter of the environment facing Berkshire's successor generation.



The above chart from Yale Economics Professor Robert Schiller shows correlations between interest rates and stocks. Correlations are not static and have gyrated between positive [rising rates good for stocks] and negative [rising rates bad for stock]. When rates rise due to inflationary fears, equities falter and correlations breakdown. Said differently, when inflation rears its ugly head rising rates are a major headwind to markets. On the other hand, when interest rates rise from very low levels [Ph.D. economists term this "normalization"] markets perform well. The idea there being that the economy has improved to the point where engineered or bond market induced accommodation is no longer necessary.

The MAAM investment team is concerned about inflation. We think inflation is under reported and could catch investors looking the other way. Recent movements in agricultural futures contracts could translate into an elevated grocery bill for

North American consumers this spring and summer. The whole self-deprecating, shy approach to investing will thus be not only more difficult to explain to tomorrow's readers but less likely to actually work.

Warren Buffett is the greatest investor the world has ever known. That Berkshire's margin of outperformance has dwindled in recent times [figure below] does not reduce the grandeur or importance of what Buffett has achieved. Instead it simply underscores just how important an integrated approach to active management will be in the coming years. Years that will be led by an entire hoard of Analysts and Portfolio Managers who cut their teeth in the investment industry during a time when 3% was considered an "elevated" interest rate figure.



Though I eventually settled on a career in financial services, my academic roots go back to the University of Toronto's Faculty of Arts and Sciences where I earned a science degree in the late 1990s. Back in those days I was much more infatuated with scientific facts than earnings ratios, bond yields or the views of some billionaire investor I had nothing in common with. In 1997 I enrolled in an inorganic chemistry course now taught by University of Guelph Professor Michael K. Denk. For the uninitiated inorganic chemistry is formally the study of chemistry that isn't carbon-based. It's a minor distinction but a dear one. Colloquially, inorganic chemistry is "cool" chemistry. You

[Buffett is still the greatest but his days of trouncing the market are behind him]

get to learn all about the periodic table of elements and the atomic structures of its constituents, and just how truly dangerous many of them are - especially in the wrong atomic state, one example being Plutonium. The periodic table of elements has grown over time. When Russian Chemistry guru Dimitri Mendeleev first formulated his Periodic Law - a sort of farsighted theoretical framework for what would become what we know as the periodic table of the elements - there were only 56 known elements and 8 that were implied or "predicted" by the table. Predicted is quoted because the elements were always there, science simply had yet to discover them. Uncovering a new element had a way of making a Scientist rather famous as it all but guaranteed a Noble Prize.

Today the periodic table of elements stands at 118 confirmed elements. The first 94 elements occur naturally while the subsequent 24 get synthesized in labs.

The first 94 elements though are an interesting bunch, especially when studied from their "known age" or timeline of discovery. Many elements were discovered a long time ago before North America was even discovered.

Another couple of the elements were discovered a *very* long time ago, like as in pre-dating classical antiquity by a wide margin long time ago. Element # 29 whose identity we intentionally have not disclosed makes other elements look downright spritely. And don't worry we include a periodic table in the appendix at the back. But if you need some clues think: bronze age or the only metal with a Ph.D., in economics [we opine on Ph.D., degrees in this edition of *The Monthly* too] and think about an inception date estimated to be 9,000 BC. The second element, whose discovery goes back to the Varna Necropolis of Bulgaria, is one of the most famed metals in the entire world and certainly in the investment world.

Whereas element # 29 can be thought of as having economic foresight, element # 79 can be viewed as having economic forbearance, and in that sense, it is widely regarded as a store of value. Fans of element # 79 acknowledge its place in a diversified portfolio of assets, fanatics preach that element #79 will take a quantum leap forward at some point in the future and be worth much more than it is today. Naysayers, like Mr. Buffett, have gone on record as saying that if he had 1 ounce of element # 79 today he would still “only” have 1 ounce of element # 79 next year and the year after.

Whether you are a believer or doubter of element # 79 the one thing you cannot dispute is that element # 79 has a proven and lengthy track record. MacNicol & Associates Asset Management was founded in September of 2001 and we’re quite proud of our own track record but element # 79 on the other hand has a track record that is 2,600 years long and that’s just as a currency. Element # 79 was first discovered by humans nearly 6,000 years ago.

As interest rates continue their slow climb higher we feel a lot of money that is currently tied up in the bond market could make its way into Element #79 over time. It’s a slow-moving train to be sure, but when you consider that the aggregate value of the world’s stock markets is around \$66 trillion it is definitely a big train. Not to mention this figure does not factor in the amount of money tied up in the world’s bonds and in currency circulation. If we get even a fraction of the money in the world’s stocks, bonds and cash making its way into Element # 79 its current price will be a memory.

Element # 79 has a reputation as a store of value. This reputation sometimes comes under fire when yields normalize.

Powell, Pragmatism and Ph.Ds

On February 5th, 2018 65-year old ex investment banker Jerome Powell took over the leadership position of the United States Federal Reserve. Vocationally Powell is a Lawyer and while he comes from a learned family he lacks a Ph.D in Economics or any formal grounding in academic economics.

We like him already...

We adored Powell’s initial days at the helm: ask a straight forward question, get a straight forward answer. The MAAM investment team just isn’t sure that Powell should be so transparent about the topic of raising rates more than the market expects. We are confident however that as he goes through his tenure, Powell’s willingness and ability to confound and befuddle will broaden. Why we place emphasis on Powell, what he says and how he says it of course relate directly to the bond market. On the day Powell gave his most recent testimony yields spiked quickly. The spike eventually faded away later in the week but as we have seen in recent months, the equity markets and certain members of the periodic table are taking their tips on direction from the bond market.



All of this is critical and tedious, because if inflation gets ahead of nominal yields, correlation breakdown could cause a major headache for investors in “traditional” balanced mandates. The MAAM Investment team has argued extensively that traditional approaches to bonds and by extension balanced portfolios, no longer apply in the sense as they do not offer investors the balance of capital protection and capital

appreciation. Famed bond fund managers like Bill Gross and Jeff Gundlach will accuse Powell of not having the academic “chops” necessary to understand debt, demographics, globalization and the stock market in an academically rigorous way.

We’re not worried...

Click or visit www.federalreserve.gov/econres/theeconomists and you will quickly realize that the US Central Bank is absolutely awash in Ph.D., Economists. We did not have the time to investigate each and every single economist’s curriculum vitae so we simply clicked on 10 of the Fed’s Economist completely randomly assuming that in one of those clicks we would unearth a non-Ph.D. level Economist, we assumed wrong as the final tally was Professors 10, Bay Street Money Managers 0.

The point is this, we like a clear transparent Fed Boss because we think it will motivate people to focus more on corporate profits and less on policy that in the past has been too vague and too deterministic at the same time.

Behavioural Investing Anxiety

We all feel nervous or worried at times. This anxiety can be a helpful feeling when it motivates us or warns us of danger. An anxiety disorder on the other hand, causes unexpected or unhelpful anxiety that seriously impacts our lives, including how we think, feel, and act. Anxiety disorders are mental illnesses. The different types of anxiety disorders include: phobias, panic disorders, agoraphobia, social and generalized anxiety.

Nearly half of Canadians (46%) are intimidated by investment decisions, and almost two-thirds feel they need to learn more about investing (60%), according to a recent survey. In addition, the survey finds that 38% of Canadians surveyed feel that they don’t have enough time to invest.

We definitely think there is an underlying anxiety on the part of investors over the present state of markets. We also believe the post Super Bowl sucker punch is still fresh on the minds of many investors who do their own analysis or turn to people like us. Raymond James recently provided us with three excellent charts that highlight what many suspect but few utter.



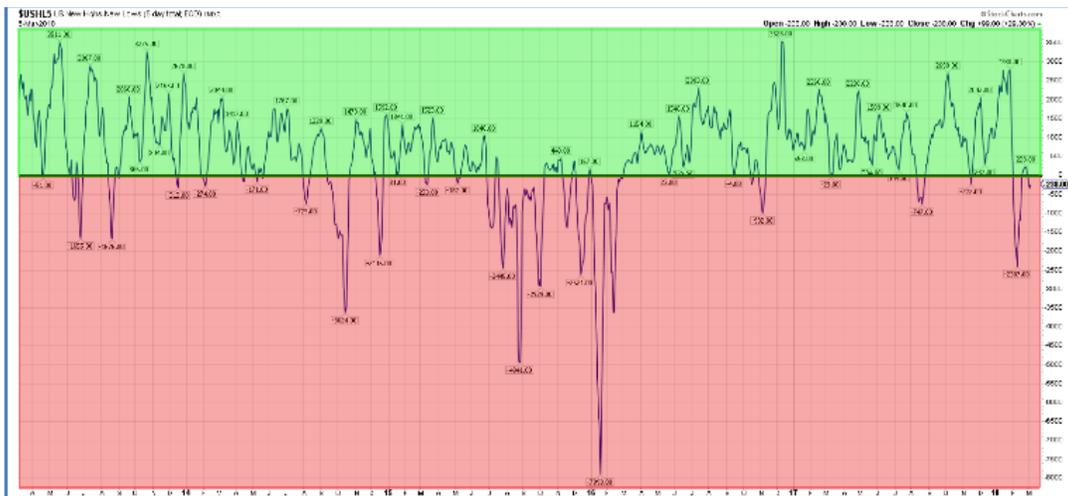
[S&P500 consolidates following the Jan//Feb declines but without a clear breakout we really don’t know what the next move will be]

Technology investors we would surmise have even more to worry about as demonstrated by the next chart.



[The tech heavy NASDAQ index faces a tough test as it bumps up against short, medium and long-term resistance trends]

And then there is the ratio of stocks hitting new highs versus those hitting new lows. It's a chart that demonstrates to us that the market has some stamina and can recover quickly but only in short bursts. As more companies make new 52-week lows than highs more and more of the "heavy lifting" falls on fewer and fewer names. One of our MAAM staff members, a seasoned Equestrian, compared this market movement to a particular breed known as the Quarter Horse. While the breed is best known for its starring roles in just about any movie filmed on a ranch, the Quarter Horse name came from its ability to outpace other breeds in races of a quarter mile. Like the short bursts we are seeing in recent market trends, a Quarter Horse race may be a quick jolt of excitement for most. Although, you never see the same type of financial return as you do in the Kentucky Derby, which is a world-famous race saved for the even more impressive Thoroughbred breed.



[Market horsepower]

Are we anxious?

The MAAM investment team has been running portfolios with elevated cash levels for a little while now and in a word, no. For us the risk is that markets steamroll previous highs with gusto and move far, far higher. Then and only then, will we be truly anxious since, as a matter of policy, our investments are thoroughly researched from the perspective of valuation, upside catalyst and positive price action. Whether markets move higher or lower is impossible to predict with certainty, even the great Warren Buffett will tell you that. What we see unfolding in 2018 is a return to a market dominated by a more clear definition of risk. The nonchalant days of 2017 are over, that much we think is for certain.

In closing we feel that anxiety, of the good kind, will cause many investors to look at the composition of their portfolios to see whether they are exposed to some of the things that concern us. If you know any such investors, please, send them our way.

We love obsessing over markets and we offer comprehensive and free portfolio evaluations.

Firm News

MacNicol Portfolio Managers David MacNicol, Ross Healy and Joe Pochodyniak were featured in an article in the National Post. MacNicol, Healy and Pochodyniak discuss how the market is splitting into two right before investors eyes. To read the full interview [CLICK HERE](#).

Conference

We are considering holding a conference in **October 2018 in Miami Beach, FL**. The main purpose would be for our clients and advisors to meet some of the members of our Alternative Asset Platform.

If you would like to be placed on our information update list, please reach out to Brook Pickering by clicking the link below.

brook.pickering@macnicolasset.com

MacNicol & Associates Asset Management Inc.

Appendix 1 The Periodic Table of Elements

Periodic Table of Elements

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 | 18 | | | | | | | | |
|---|--|--|--|--|---|--|--|---|---|--|--|---|---|---|---|---|--|---|---------------------------------------|---|------------------------------------|---|------------------------------------|-------------|--------------------------------------|
| 1 H Hydrogen 1.00794 | <div style="display: flex; justify-content: space-between;"> <div style="width: 20%;"> <p>C Solid</p> <p>Hg Liquid</p> <p>H Gas</p> <p>Rf Unknown</p> </div> <div style="width: 60%; text-align: center;"> <table border="1"> <tr> <td style="background-color: #f0f0f0;">Alkali metals</td> <td style="background-color: #ffff00;">Alkaline earth metals</td> <td style="background-color: #ffe0e0;">Lanthanoids</td> <td style="background-color: #ffe0e0;">Actinoids</td> <td style="background-color: #ffe0e0;">Transition metals</td> <td style="background-color: #ffe0e0;">Poor metals</td> <td style="background-color: #90ee90;">Other nonmetals</td> <td style="background-color: #90ee90;">Noble gases</td> </tr> </table> </div> <div style="width: 15%; text-align: right;"> <p>2 He Helium 4.002602</p> </div> </div> | | | | | | | | | | | | | | | | Alkali metals | Alkaline earth metals | Lanthanoids | Actinoids | Transition metals | Poor metals | Other nonmetals | Noble gases | 2 He Helium 4.002602 |
| Alkali metals | Alkaline earth metals | Lanthanoids | Actinoids | Transition metals | Poor metals | Other nonmetals | Noble gases | | | | | | | | | | | | | | | | | | |
| 3 Li Lithium 6.941 | 4 Be Beryllium 9.012182 | | | | | | | | | | | | | | | | | 5 B Boron 10.811 | 6 C Carbon 12.0107 | 7 N Nitrogen 14.007 | 8 O Oxygen 15.9994 | 9 F Fluorine 18.9984032 | 10 Ne Neon 20.1797 | | |
| 11 Na Sodium 22.98976928 | 12 Mg Magnesium 24.305 | | | | | | | | | | | | | | | | | 13 Al Aluminum 26.9815385 | 14 Si Silicon 28.0855 | 15 P Phosphorus 30.973762 | 16 S Sulfur 32.06 | 17 Cl Chlorine 35.45 | 18 Ar Argon 39.948 | | |
| 19 K Potassium 39.0983 | 20 Ca Calcium 40.078 | 21 Sc Scandium 44.955912 | 22 Ti Titanium 47.887 | 23 V Vanadium 50.9415 | 24 Cr Chromium 51.9961 | 25 Mn Manganese 54.938045 | 26 Fe Iron 55.845 | 27 Co Cobalt 58.933195 | 28 Ni Nickel 58.6934 | 29 Cu Copper 63.546 | 30 Zn Zinc 65.38 | 31 Ga Gallium 69.723 | 32 Ge Germanium 72.64 | 33 As Arsenic 74.9216 | 34 Se Selenium 78.96 | 35 Br Bromine 79.904 | 36 Kr Krypton 83.798 | | | | | | | | |
| 37 Rb Rubidium 85.4678 | 38 Sr Strontium 87.62 | 39 Y Yttrium 88.90585 | 40 Zr Zirconium 91.224 | 41 Nb Niobium 92.90638 | 42 Mo Molybdenum 95.96 | 43 Tc Technetium (97.9072) | 44 Ru Ruthenium 101.07 | 45 Rh Rhodium 102.90550 | 46 Pd Palladium 106.42 | 47 Ag Silver 107.8682 | 48 Cd Cadmium 112.411 | 49 In Indium 114.818 | 50 Sn Tin 118.710 | 51 Sb Antimony 121.760 | 52 Te Tellurium 127.60 | 53 I Iodine 126.90447 | 54 Xe Xenon 131.293 | | | | | | | | |
| 55 Cs Caesium 132.9054519 | 56 Ba Barium 137.327 | 57-71 | 72 Hf Hafnium 178.49 | 73 Ta Tantalum 180.94788 | 74 W Tungsten 183.84 | 75 Re Rhenium 186.207 | 76 Os Osmium 190.23 | 77 Ir Iridium 192.222 | 78 Pt Platinum 195.084 | 79 Au Gold 196.966569 | 80 Hg Mercury 200.59 | 81 Tl Thallium 204.3833 | 82 Pb Lead 207.2 | 83 Bi Bismuth 208.98040 | 84 Po Polonium (209.9824) | 85 At Astatine (208.9871) | 86 Rn Radon (222.0176) | | | | | | | | |
| 87 Fr Francium (223) | 88 Ra Radium (226) | 89-103 | 104 Rf Rutherfordium (261) | 105 Db Dubnium (262) | 106 Sg Seaborgium (266) | 107 Bh Bohrium (264) | 108 Hs Hassium (277) | 109 Mt Meitnerium (268) | 110 Ds Darmstadtium (271) | 111 Rg Roentgenium (272) | 112 Uub Ununbium (285) | 113 Uut Ununtrium (284) | 114 Uuq Ununquadium (289) | 115 Uup Ununpentium (288) | 116 Uuh Ununhexium (292) | 117 Uus Ununseptium | 118 Uuo Ununoctium (294) | | | | | | | | |

For elements with no stable isotopes, the mass number of the isotope with the longest half-life is in parentheses.

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|--|---|--|---|--|---------------------------------------|--|---|---|--|---|--------------------------------------|--|---|---|
| 57 La Lanthanum 138.9047 | 58 Ce Cerium 140.116 | 59 Pr Praseodymium 140.9076 | 60 Nd Neodymium 144.242 | 61 Pm Promethium (145) | 62 Sm Samarium 150.36 | 63 Eu Europium 151.964 | 64 Gd Gadolinium 157.25 | 65 Tb Terbium 158.92535 | 66 Dy Dysprosium 162.500 | 67 Ho Holmium 164.93032 | 68 Er Erbium 167.256 | 69 Tm Thulium 168.93421 | 70 Yb Ytterbium 173.054 | 71 Lu Lutetium 174.9668 |
| 89 Ac Actinium (227) | 90 Th Thorium 232.03806 | 91 Pa Protactinium 231.03688 | 92 U Uranium 238.02891 | 93 Np Neptunium (237) | 94 Pu Plutonium (244) | 95 Am Americium (243) | 96 Cm Curium (247) | 97 Bk Berkelium (247) | 98 Cf Californium (251) | 99 Es Einsteinium (252) | 100 Fm Fermium (257) | 101 Md Mendelevium (258) | 102 No Nobelium (259) | 103 Lr Lawrencium (262) |