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

May 2018

The Monthly

With this commentary, we plan to communicate with you every month about our thoughts on the markets, some snap-shots 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.

"I wasn't actually in love but I felt a sort of tender curiosity"

- *The Great Gatsby*, F. Scott Fitzgerald

The Numbers:

Index:		**Year-to-Date:**
S&P/TSX:		-7.05%
NASDAQ:		+5.27%
Dow Jones:		-1.45%
S&P500:		-0.06%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	1.21%	1.89%
5-Year Bond:	2.20%	2.84%
10-Year Bond:	2.39%	3.01%
30-Year Bond:	2.45%	3.16%

Economic Data:

- US 10-year yield crosses 3% in late April and continues to float in the 2.95% range as of this report
- The Bank of Canada held rates at 1.25% at its April policy meeting however the implied odds from swaps trading show a 95% chance of two increases by the end of the year
- Canada lost 1,100 jobs during the month of April
- Aurora Cannabis agrees to buy rival MedReleaf
- The Bank of Japan maintained loose monetary policy but scrapped a time frame for achieving a predefined inflation target
- Gold off slightly for the month of April after having reached the $1,350 level earlier in the month

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	21.4	19.3
P/B: Price-to-Book	3.0	2.9
P/S: Price-to-Sales	2.1	2.0
Yield: Dividend Yield	1.98%	2.15%

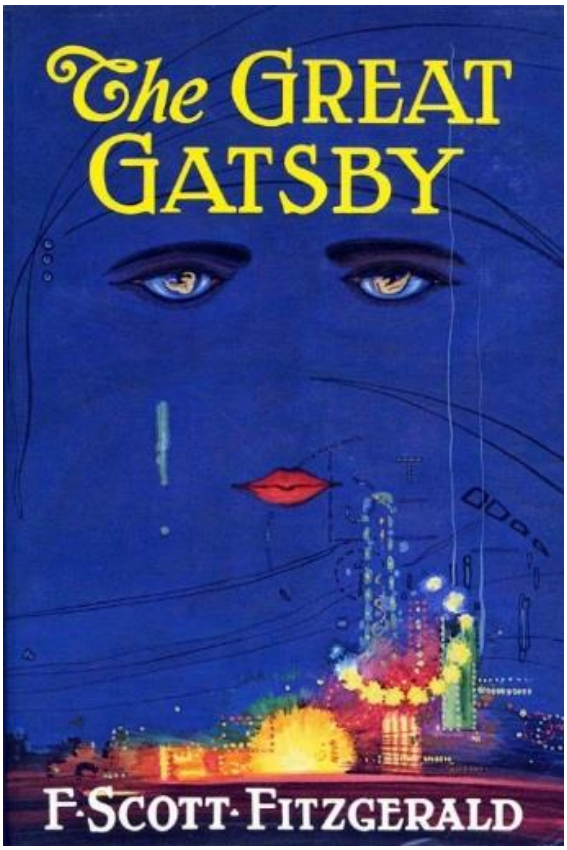
Year-to-date Performance, by Sector: May 9th, 2018

U.S. Markets	Close	Net	1 Day %	YTD %
Dow Jones	24360.21	2.89	0.01%	-1.45
Dow Jones Transports	5107.92	79.46	1.58%	0.65
Dow Jones Utilities	683.77	-16.57	-2.37%	-5.47
S&P 500	2671.92	-0.71	-0.03%	-0.06
S&P 400 Midcap	1913.91	5.99	0.31%	0.70
S&P 600 Smallcap	974.77	8.28	0.86%	4.11
NASDAQ	7266.90	1.69	0.02%	5.27
Russell 2000 (Smallcaps)	1586.39	7.44	0.47%	3.31
BKX (Banking)	108.17	1.10	1.03%	1.37
BTK (Biotech)	4506.88	-29.90	-0.66%	6.74
XOI (Oil Index)	1487.79	9.64	0.65%	11.40
SOXX (Semiconductor)	1318.02	9.55	0.73%	5.19
XAU (Gold/Silver)	82.67	0.67	0.82%	-3.06

Source: Jeffrey Saut, Raymond James

Decadence, Idealism and Submission to Change

Look up "American literary giants" on any internet search engine and a who's who of famed writers dominates your computer screen. Names like; Mark Twain, Nathaniel Hawthorne, Harper Lee and Nobel Laureate, Ernest Hemingway are your internet search engines highest ranking results, and justifiably so. Not only are the fabled four we just referenced, plus others of their ilk, the reigning champions of American literature, they are part of America's fabric too. Each writer had his or her own unique style and philosophical stance that were undoubtably shaped by either real life experiences or stories as impactful as the ones they produced for us.

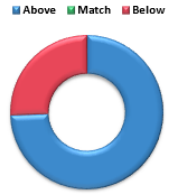


Though the list of icons mentioned above provides a great starting point to this edition of *The Monthly*, it would be incomplete without the name F. Scott Fitzgerald. Fitzgerald is regarded as the top name in American literature who embodied the roaring 20's and its penchant for decadence, idealism and irreverence. Fitzgerald left his peers too early making it just a smidgen past the age of 44. Though his magnum opus *The Great Gatsby* lives on and bears an uncanny resemblance to modern financial markets inasmuch as it explores decadence and idealism but incorporates cautionary lessons in its exploration.

In this edition of *The Monthly* the MAAM investment team explores the decadence and idealism of contemporary capital markets while offering a cautionary lesson of its own.

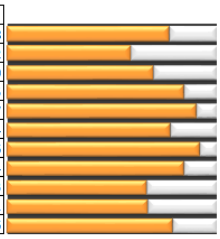
Up until now, stock markets around the world have offered investors a sort of financial version of debauchery: that investing is simple, enjoyable and for the most part devoid of the need for careful, thorough and meticulous attention to detail. That one can simply toss money at the central dogma of saving, which is defeating inflation, is an aperitif that has been on offer since the implosion of Lehman Brothers in September 2008. However, stock markets of late have not exactly been seducing investors with their growth. As a matter of fact, markets have been a lot more submissive?

Our investment team has provided us with the following two "score cards," as seen below, of earnings and revenues. We are very interested in quantitative analysis and we are proponents of investing in things with intrinsic value. The graphs below certainly offer the reader a lot of data but keep in mind that these are simply two methods of showing how much "stuff" companies are selling and how much money they keep after selling it.



	Above	Match	Below
S&P 500 INDEX	**74%**	**0%**	**26%**
Consumer Discretionary	78%	0%	22%
Consumer Staples	74%	0%	26%
Energy	62%	0%	38%
Financials	63%	0%	37%
Health Care	71%	0%	29%
Industrials	88%	0%	13%
Materials	71%	0%	29%
Information Technology	93%	0%	7%
Telecommunication Services	50%	0%	50%
Utilities	50%	0%	50%

	Reported	Remaining
S&P 500 INDEX	**359**	**108**
Consumer Discretionary	46	32
Consumer Staples	23	10
Energy	26	5
Financials	62	7
Health Care	48	14
Industrials	64	6
Materials	21	4
Information Technology	45	23
Telecommunication Services	2	1
Utilities	22	6



This is the revenue table, the key points to note are:

a) Roughly 75% of companies that reported as at the writing of *The Monthly* beat Analyst expectations, this is good

b) With fewer than 25% of companies yet to report, it is unlikely that this level of "opulence" gets materially reduced.

This Portfolio Manager personally loves revenues. It comforts me to know the cash register is ringing in a new sale but our friends in the United States like to quip "what's the bottom line?"

Let's take a look

This is the net income table, the key points to note are:

a) More than 75% of companies that reported as at the writing of *The Monthly* beat Analyst expectations, this is just great.

b) With fewer than 25% of companies yet to report, it is unlikely that this level of "opulence" gets materially reduced.

SCORE CARD

	Above	Match	Below
S&P 500 INDEX	**81%**	**7%**	**13%**
Consumer Discretionary	74%	7%	20%
Consumer Staples	87%	0%	13%
Energy	73%	12%	15%
Financials	79%	10%	11%
Health Care	88%	4%	8%
Industrials	81%	8%	11%
Materials	76%	5%	19%
Information Technology	93%	4%	2%
Telecommunication Services	50%	0%	50%
Utilities	64%	9%	27%

	Reported	Remaining
S&P 500 INDEX	**360**	**107**
Consumer Discretionary	46	32
Consumer Staples	23	10
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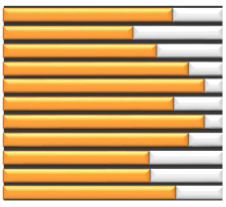


It is fair to say that corporate America is doing pretty well, given the information provided above.

The Global, Geopolitical Situation

Though the recent decision by the United States to turf the Iran deal sobers up our story somewhat, let's approximate the geopolitical situation as "constructive".

The Leaders of North and South Korea are not merely holding hands…they have vowed to end their decades long war.

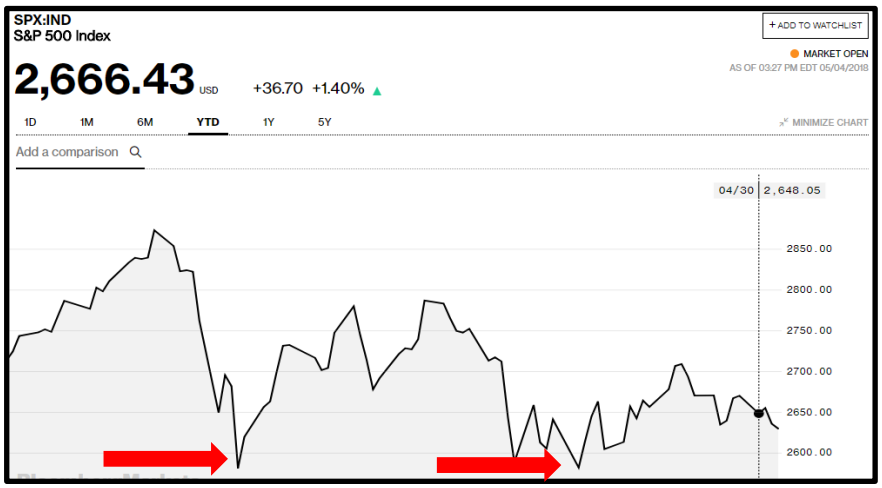
Thus, revenues are good, corporate profits are good, geopolitical risk is, for the most part, is fading. So what have we missed? Trade talks of course.

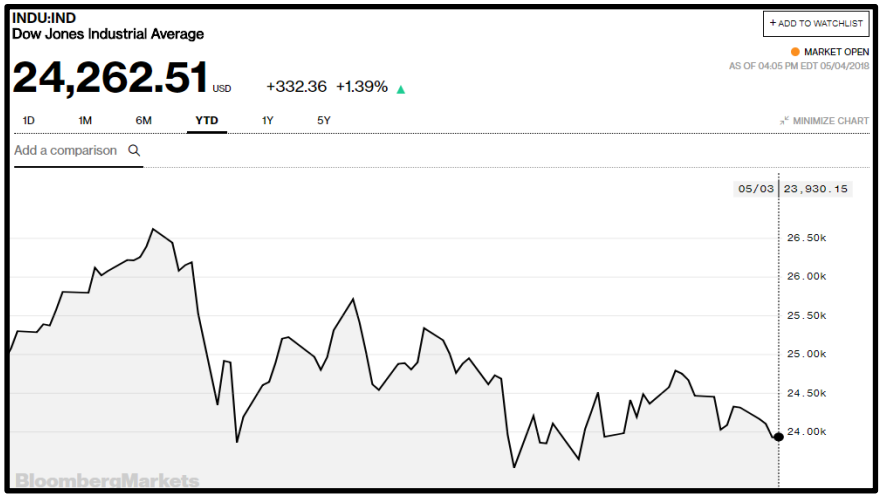
For what it is worth China and the White House have put their trade "war" on the back burner…

"I am so glad we didn't let a little thing like tariffs get in the way of such a great friendship."

With corporations and most political leaders in a state of euphoria, the expectation would be stock markets to be blissfully and bullishly bounding higher. This is what we call fake news.

The S&P500 lacks the luster that strong sales and earnings figures would suggest. We are not worrying just yet but a break below the February and April lows (red arrows) would cause us concern. Source Bloomberg.





The Dow Jones Industrial Average looks no better. Source Bloomberg.

Decade of Opulence and Idealism

The MAAM investment team continues to feel that the answer is an unambiguous maybe. We seem to be getting asked more and more these days whether market movements since the January/February debacle are, to quote Winston Churchill, "the end of the beginning." Like F. Scott Fitzgerald, markets of the past decade were intoxicated for most of the time. A double shot of low interest rates and high liquidity made even the most uninitiated of individuals capable of generating decent investment returns. Now that the bill has arrived, reality is quickly sinking in. The MAAM investment team believes that recent reports from the corporate sector absolutely have the benefit of the Trump tax cuts baked into the cake. This is one of the reasons why stocks are not moving significantly higher. We also think that investors are finally beginning to view their portfolios holistically and in the context of inflation. Herein lies our cautionary message, and reasons for holding cash dear and investing cautiously. Whenever we get asked our views on "the markets" we first respond by asking: which markets?

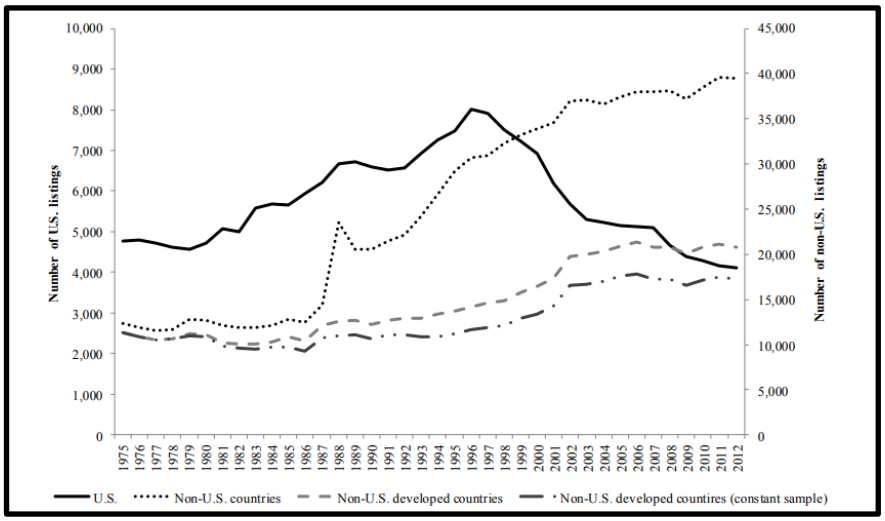
Whenever we get asked our thoughts on alternatives we ask "do you hold alternative investments currently?" As developed markets the world over mature and global central banks begin the great unwind, more and more investors will have to come to grips with the fact that traditional approaches to staving off inflation may not work. The investor of tomorrow will have to look at a wider range of asset classes like our Alternative Asset Trust and Alternative Debt Fund, and they will have to look more globally. The good news for investors who have done their own analysis and concluded the ideals of the past decade; are indeed submitting to a new investment normal a sea of change does not imply stormy waters.

At some point all good parties come to an end, a well diversified portfolio of conventional and alternative assets doesn't have to

The MAAM Investment Team

The Stock Market: Bigger, Yet Smaller In Some Markets

Maybe the hours spent pouring over financial reports and spreadsheets develops in us a sort of seriousness that in turn makes us susceptible to the occasional mental silliness that oxymorons offer. Last year the MAAM investment team had trouble keeping track of the number of new record highs many of the world's stock markets made on a seemingly daily basis. You might say things got pretty ugly. Volatility was noticeably absent and the performance of stocks was awfully good. However, looking at things over a 20-year time frame led us to a conclusion free of contradictions or rhetorical effect. The number of publicly listed companies in the United States has fallen over the past two decades. Credit Suisse, a large global investment house, recently reported that the number of publicly traded US firms has been slashed in half over the past 20 years. According to Credit Suisse, 3,671 companies had shares of their stock actively traded on an active secondary market, the technical term for "stock market", at the end of 2017 versus 7,322 two decades previously. Surely not all firms failed to meet the listing requirements of the exchanges or went flat out going bankrupt. Some companies like Uber and Airbnb simply delayed, postponed or cancelled their plans for an IPO. The decline in publicly traded companies over the past 20 years has been significant enough to draw the attention of the academic world. Finance Professors Craig Doidge, Rene Schultz and Andrew Karolyi were curious enough to publish "*The Listing Gap*", a paper published in the National Bureau of Economic Research.



University of Toronto, Ohio State and Cornell University Professors Craig Doidge, Rene Schultz and Andrew Karolyi demonstrate that the United States has an abnormally small level of publicly traded companies given its level of development and the quality of its institutions.

The number of publicly listed companies in the United States has fallen sharply while listings outside of the United States have increased. From that sense, developed markets are growing smaller allowing fewer individual names with gargantuan valuations, for example Apple and Amazon. To avid investors it is a well known secret that private equity has been one of the main culprits. To be sure, takeovers of public companies by other public companies remain the more robust explanatory variable but the role of private equity over the past two decades has been awfully good at explaining the decline as well.

Maybe Jensen was right when he wrote "the publicly held corporation has outlived its usefulness in many sectors of the economy" (1989). The inherent conflict of a public corporate structure often puts owners and managers of a company on different sides of the table. Private corporations offer investors a better governance structure because investors are partners and the focus is on the business and not on meeting obscure regulatory hurdles or the quarterly earnings expectations of analysts. To many, the fact that many public companies are being swallowed by large global private equity firms is no oxymoron at all.

With stock markets either peaking or sucking wind to attain ever higher levels, some of the world's largest pension programs are moving further into the space to keep pace with the stable return profiles their constituents require.

When assessing your overall portfolio don't limit yourself to choices that are traded daily. To us you are much more than "just another client" and in the world of private investments you are much more than "just another shareholder."

Confusion: Multiple Data Points Misunderstood

The encyclopedia of psychology defines confusion as:

"A loss of logical orientation, and often of memory as well, due to a lack of normal brain function caused by injury or age".

The MAAM investment team defines confusion as: being presented with a cacophony of conflicting information that compels one to make a decision on short notice. Our clients and trusted partners in the industry seem to be having an exceptionally challenging time with the Iran Deal. Although a myriad of other things are going on in global financial markets, for example all of Asia, few stories have caused our inboxes to overflow more than the President's decision to exit the Iran deal. The deal exit itself is not so much the page 1 story but rather the aftermath: how can crude oil, the US dollar and US rates all go UP at the same time?

In confusing times such as these, the MAAM investment team always suggests a big, deep breath. The Iran deal is obviously bullish for oil but it certainly does not answer the US dollar dilemma. Inflation expectations do. As long as Treasury investors maintain their conviction that the US Fed is indeed worried about inflation [i.e. fiscal stimulus plus an economy that is more-or-less operating at full throttle] we see little reason why the US dollar and rates cannot rise higher. In Asia, with supply side reforms delivering the goods we see Crude Oil well supported too. Besides, it's not like money is set to pile into the Eurozone. Peter Praet, Eurozone Chief Economist acknowledged that the Eurozone's slowdown came quicker than expected, and in a fashion that suggests more than just a 'blip' on the economic radar screen. Don't get us wrong the Iran deal helped oil prices in the near term. However, without specific guidance of what the curtailments are the MAAM investment team views Asia's economic growth, the Eurozone's stumble, and US fiscal expansion as the key drivers of crude, rates and the US dollar.

A side note to Canadian Oil execs and Politicians; you might just want to focus on getting more of your oil to more global markets and quickly.

Firm News

MacNicol & Associates is pleased to announce we are hosting an alternative investment conference in South Beach Miami this October. To learn more please email brook.pickering@macnicolasset.com.

MAAM Portfolio Managers David MacNicol and Joe Pochodyniak are in New York in late May for discussions with Managers and influential investors.

MacNicol & Associates Asset Management Inc.