

April 2018

The Quarterly

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.

"If the world economy gets better, commodities are very good place to be in... even if the world economy does not improve, commodities are still a fabulous place to be."

- Investment Guru Jim Rogers

The Numbers:

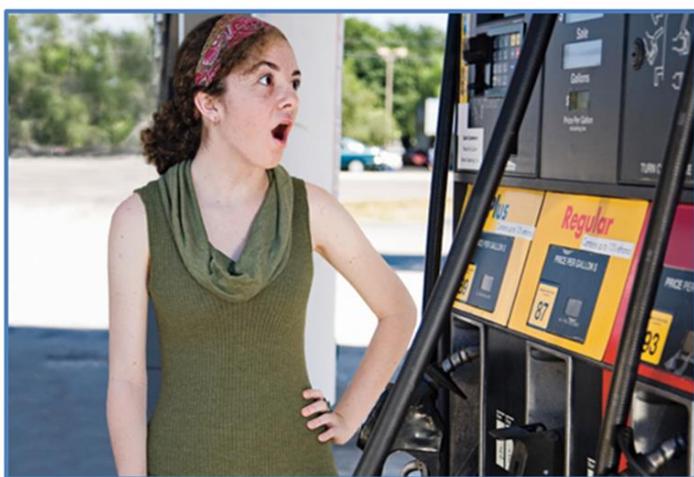
<u>Index:</u>	<u>Year-to-Date:</u>	
S&P/TSX:	+8.51%	
NASDAQ:	+5.68%	
Dow Jones:	+0.12%	
S&P500:	+1.31%	
<u>Interest Rates:</u>	<u>Canadian</u>	<u>US</u>
90-Day T-Bill:	1.20%	1.82%
5-Year Bond:	2.16%	2.75%
10-Year Bond:	2.32%	2.91%
30-Year Bond:	2.43%	3.10%
<u>Economic Data:</u>		
<ul style="list-style-type: none"> • Crude Oil approaches \$70 US a barrel • US Initial jobless claims largely in line with expectations • Gold higher at \$1,350 • Bank of Canada keeps rates where they are but forward guidance is hawkish 		

<u>Valuation Measures: S&P 500 Index</u>				
<u>Valuation Measure</u>	<u>Latest</u>	<u>1-year ago</u>		
P/E: Price-to-Earnings	22.3	20.8		
P/B: Price-to-Book	3.10	2.90		
P/S: Price-to-Sales	2.10	2.00		
Yield: Dividend Yield	2.33%	2.42%		
<u>Year-to-date Performance, by Sector: April, 2018</u>				
<u>U.S. Markets</u>	<u>Close</u>	<u>Net</u>	<u>1 Day %</u>	<u>YTD %</u>
Dow Jones	24748.07	-38.56	-0.16%	0.12
Dow Jones Transports	10770.15	177.59	1.68%	1.49
Dow Jones Utilities	697.82	-2.42	-0.35%	-3.53
S&P 500	2708.64	2.25	0.08%	1.31
S&P 400 Midcap	1922.80	5.44	0.28%	1.17
S&P 600 Smallcap	975.10	2.91	0.30%	4.15
NASDAQ	7295.23	14.14	0.19%	5.68
Russell 2000 (Smallcaps)	1583.56	3.76	0.24%	3.13
BKX (Banking)	104.91	-0.58	-0.55%	-1.68
BTK (Biotech)	4661.47	-4.77	-0.10%	10.40
XOI (Oil Index)	1461.56	23.66	1.65%	9.43
SOXX (Semiconductor)	1343.78	-13.94	-1.03%	7.24
XAU (Gold/Silver)	85.21	1.00	1.19%	-0.08

Sticker shock

I drive a small car in the narrow, congested, claustrophobic city of Toronto. Every single inch of road is absolutely stuffed with construction crews flagged by Toronto Police Officers drinking coffee, potholes or other vehicles, which are much bigger than my own. Having a small car means you can just hop in and zip anywhere you need to go. Having a small car also means cheaper repair bills, a noticeably less dented or scratched vehicle and [emphasis implied] cheaper fuel bills. That last point makes us me somewhat of an expert when it comes to energy prices. Whether the owner of a gigantic SUV or pick up truck is misappropriated out of \$100 or \$150 matters little to them in the grander scheme of things.

For us \$60 represents the psychological signal that compels all of us to dig through energy reports and hit the “Eco mode” button on my already frugal little German car.



[The price I pay for data privacy...thanks Uber...]

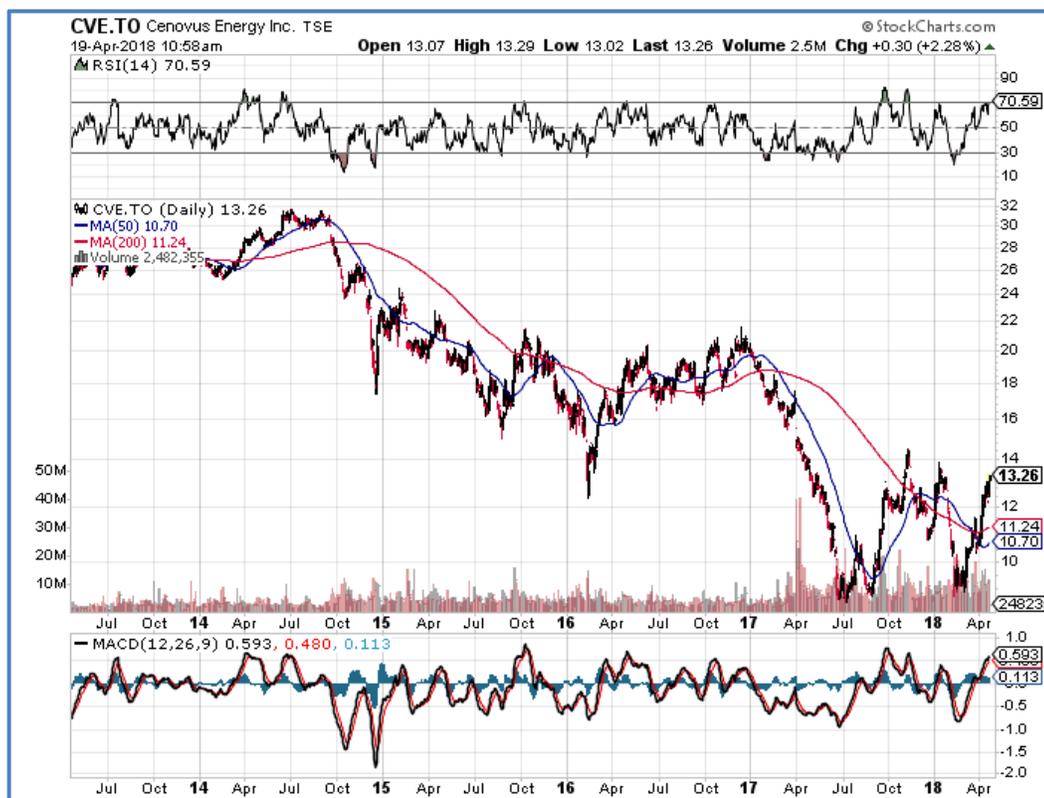
the space could persist for longer as it really didn't get going until more recently. Higher energy prices mean higher headline and potentially higher core inflation readings. Everything costs money and this seepage of inflation may prompt consumers to adjust their spending habits and we see this in things like the share price of Marlboro Cigarettes, which now goes by the name of Altria Group [MO:NYSE].

My family physician once said; “Any reasons you choose to quit smoking is a good one”, who knew that rising energy prices were one of those reasons

The MAAM investment team sees several positive trends that we feel will support oil prices and the valuations of particular Canadian energy producers. On the one hand they will lead to more pain at the pump, but on the other hand they do represent opportunities for investors. US oil inventory levels have been falling despite all the hype surrounding US oil production. On paper, total US inventories of crude oil and petroleum distillates are down 11% on a year over year basis. The futures market also supports higher oil prices as the closest contract price is now well above the 12-month forward contract price; a situation Economists call Backwardation. Backwardation is an indicator of a tight market. From a seasonal perspective oil and oil producers tend to top out in February of most calendar years, but we think strength in



Inflation also tends to motivate investors to look at their portfolios a bit more carefully than “some stuff has gone up, other stuff has gone down”. Inflation is a silent destroyer of capital and in order to hedge that destruction investors have to ask themselves a simple question: am I likely to get the kind of growth I experienced out of the “stuff” that has gone up in the past on a moving forward basis? The “stuff” that has gone down is cheap and thus a lot more likely to inflate with inflation. Energy stocks have had a very tough time during the past few years including a head fake or two.



We attach a 5-year chart of Canada's Cenovus Energy, however there are many charts that look like this one.

The MAAM investment team has been underweighting energy companies for a while now and maybe it is time to dive in with both feet. Stocks in the space are likely to represent much better value than as an example, Netflix, which one of our Analysts pointed out in the below heat map was up over 70% in 2018 alone. According to his methodology, Netflix is now likely priced for a pull back of as much as 85%. Remember, our macro theme is that a broader unwind occurs in 2019 when a deluge of US Treasuries from deficit spending and Central Bank redemptions hits the bond market. Although, it is never too early to plan.

Finviz's heatmaps are fun to look at and this recent one is no exception: check out the size of Amazon which is equivalent to Walmart, Costco, Target Corporation and both Dollar Stores combined. The glowing and almost effervescent Netflix we circle in the image shown here.

At MAAM, we choose to play the space more cautiously through companies connected to the energy industry by a series of tolls. We call them energy services firms like TransCanada Corporation which bill for the privilege of transporting crude through a series of pipelines not unlike the way Rogers, Telus and BCE bill for the privilege of transporting data through their network of virtual and fiber optic pipelines.

However, the commodity rally is accelerating not abating as naysayers of the space might suspect. The below chart from Bloomberg shows Aluminum prices moving higher and pulling Nickel along for the ride.



[Aluminum strength not only confirms health in manufacturing but also pulls metals like Nickel along for the ride]

Broadening commodity strength not only refocuses our attention on the space but directs our attention to the producers, not just the servicing companies.

At this point in the cycle we continue to watch the producer space carefully. Our foray into oil and gas began with baby steps. Furthermore, commodity price strength and in particular upward earnings revisions will be viewed by us as a positive.

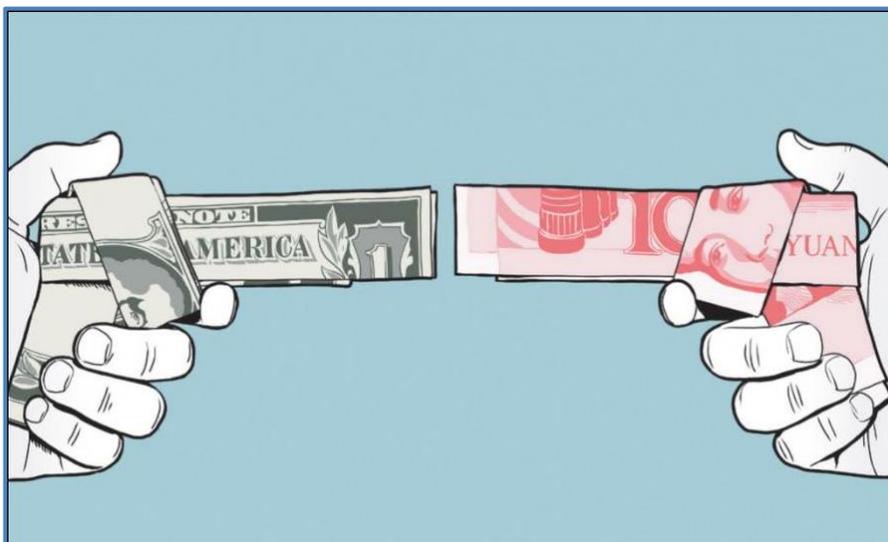
Inflation is coming to a portfolio near you. As the enemy of those with capital - inflation is a force not to be taken lightly. Call us today for an independent, unbiased view on inflation and what it can mean for you.

Trade Wars: Protectionism's Unfortunate End Game?



Recently tabled US fiscal stimulus measures have stoked domestic demand, which will raise imports not lower them...he didn't TWEET about that.

Protectionism is great to experience in action, especially when it is trying to seduce voters. Once in office though, protectionism can lead to trade wars. A trade war is when Country A launches tariffs or quota restrictions against the imports of Country B. A North American example would be the United States heavily taxing imports of Canadian hockey pucks or maple syrup. Now if one takes the view that globalization has only benefitted the upper tier of society at the expense of so many others, then trade wars have their place. On the other hand, many academic economists will argue that the United States has actually benefitted from globalization because they are able to purchase goods made elsewhere for less than they would cost were they produced in America. Trade wars may be instigated when one country perceives another country's trading practices to be unfair or when domestic unions pressure politicians to make imported goods less attractive to consumers. The problem is that trade wars may also be a result of a huge misunderstanding as to the wide spread benefits of free trade such as access to higher quality goods at a lower price. The MAAM investment team of course is not qualified to weigh in on the future of global trade, but we will say this: the benefits of trade are often diffuse and hard to see, while the benefits of protectionism are usually immediate and visible. At the very least it makes you think.



With the official start of the trade war between Washington and Beijing many investors are asking themselves “how do I protect my capital?” This is a very good question. The Chinese Embassy had this to say on US-China trade relations: “We urge the US to *cease and desist, make cautious decisions and avoid placing China/US trade relations in danger with the purpose of hurting others that eventually end up hurting itself*”. The message does not appear to be getting through to the brain trust at 1600 Pennsylvania Avenue. Unfortunately, this is taking down a lot of great companies with it. The figure below shows shares of Qualcomm Inc., which finds itself in the

unfortunate situation of being placed smack dab in the middle of a showdown between the United States and China.

Qualcomm shares hurt simply by being on the same battlefield as the USA and China



On Monday, Qualcomm lost its ability to export semiconductors to one of its biggest clients, a company called ZTE Corporation. The ban is in place for 7-years. What’s more a move by Qualcomm to acquire NXP semi-conductors has been stalled by a protracted anti-trust review. Some see the extended review as Chinese retaliation to aggressive trade moves on the part of the United States. The Chinese used the words “more concessions” when describing moves the company would have to undertake to maybe get the deal approved. The White House in turn is preparing more restrictions. We are not entirely sure what the White House is thinking but for some reason we cannot evade the

expression “cutting off the nose to spite the face”. Restrictions on foreign trade all too often harm the very people they aim to protect: American consumers and producers. Trade restrictions limit the choices of what Americans can buy and drive up the prices of everything from clothing and groceries to the materials manufacturers use to make everyday products. Affluent Americans care not and choose patriotism or pragmatism since they bear a disproportionate tiny share of these costs. Trade treaties increase freedom to trade and do not result in loss of sovereignty; they are part and parcel of wider international relations and they are not new.

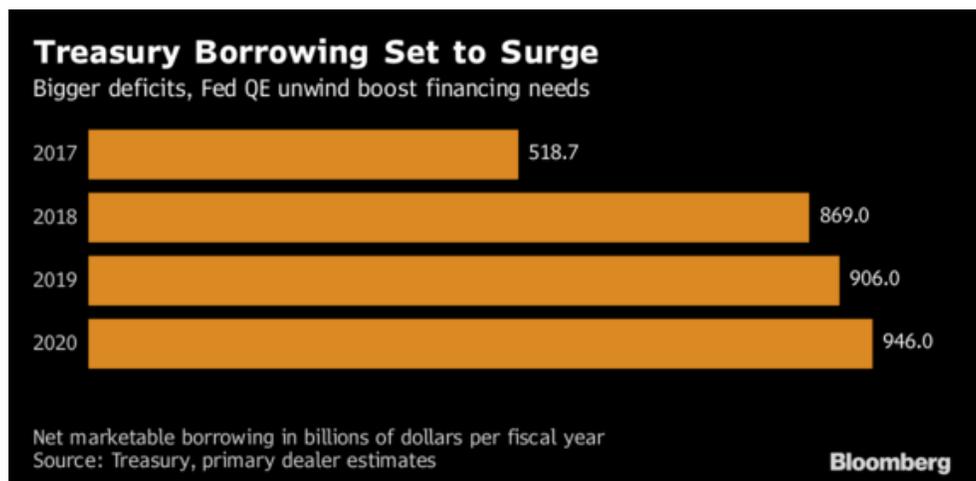
We hope trade brinkmanship changes however for the time being the investment implications are really quite straight forward, avoid companies that do business with China. Simple yet unfortunate.

Market Agoraphobia

Agoraphobia, according to *Psychology Today*, is defined as “the fear of crowded spaces or enclosed public places”. Somewhere around page 16 we discovered that according to Doctors pure agoraphobia is not that common. On the other hand, in cases where other panic disorders exist agoraphobia has a much greater instance of being represented. We consult the stock market every day and overall agoraphobia seemed sparse in 2017. Things like Central Bank policy, geopolitical risk and inflation were always in the background, but were never truly a concern. Investors continued to pile into the latest ETF’s and momentum-based trading strategies from the comfort of their smart phones, then sat back and watched as the profits uploaded to their screens.

Well unfortunately, we think the other panic disorder that is poised to overwhelm the minds of investors in 2018 and 2019 is tsunamiphobia; the fear of being hit by a tsunami. What tsunami are we referring to?

Whose buying, whose selling...



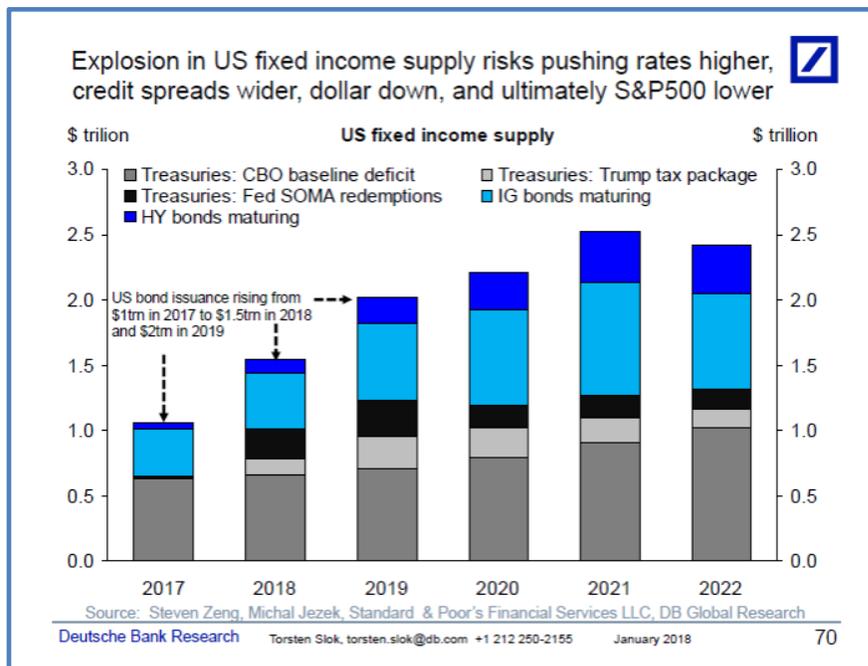
Larger US Treasury Note sales coming

Tsunamiphobia’s biggest victim we think will be those predisposed to a suppressed variant of agoraphobia. The above table from Bloomberg aggregates larger deficits and a tighter Federal Reserve. The supply of short and medium-term maturities is set to balloon and most of us will be left wondering whether bond buyers can keep up. President Trump tweets that the economic stimulant of tax cuts will make up for lost revenues but we’re not so sure. That China and other buyers of US Treasuries have mixed intentions at precisely the same time as bond issuance sets to explode makes us concerned.

Let's hope demand for US Treasuries doubles...otherwise rates will move higher, credit spreads will expand and the US dollar and stocks could decline

Fixed income fiascos of this magnitude are slow moving trains. Slow moving because of the sheer size of the problems that face us and because we really are in uncharted territory.

Protecting client capital and growing it prudently over time are what we are all about at MacNicol & Associates Asset Management. If you are feeling fearful or anxious about any aspect of your portfolio or know someone who is give us a call. Sometimes you have to move yourself back to the centre of the table to feel better about the world around you.



Firm News:

The MAAM Investment team attended a private equity conference sponsored by Northleaf Capital Partners.

The MAAM Investment team conducted mid-west commercial office space due diligence recently solidifying our understanding of the market at the ground level.

MacNicol & Associates will be hosting an Alternative Investment Conference in October 2018 in Miami Florida. To receive all updates and details of the conference please email brook.pickering@macnicolasset.com.

MacNicol & Associates Asset Management Inc.

