MacNicol & Associates Asset Management Inc.
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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.

"The market can move for irrational reasons, and you have to be prepared for that…you need to make big bets when the odds are in your favor – not big enough to ruin you, but big enough to make a difference"

- Bill Gross

The Numbers:

Index:		**Year-to-Date:**
S&P/TSX:		1.12%
NASDAQ:		13.29%
Dow Jones:		4.21%
S&P500:		6.86%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	1.48%	2.07%
5-Year Bond:	2.19%	2.72%
10-Year Bond:	2.26%	2.84%
30-Year Bond:	2.28%	3.01%

Economic Data:

- Domestic equity market volumes were lower in August but broadly consistent with past summers
- US Dollar maintained strength in July and August
- Gold was notably weaker during the month
- Oil prices nearly touched their June lows as inventory data helped ease demand concerns
- Yield curve flattening continued across North American bond markets
- Canadian labour markets were strong though the unemployment rate ticked down mainly on part-time hiring

Valuation Measures: S&P 500 Index

Valuation Measure	Latest	1-year ago
P/E: Price-to-Earnings	17.7	18.8
P/B: Price-to-Book	3.10	2.90
P/S: Price-to-Sales	2.0	2.00
Yield: Dividend Yield	1.86%	1.96%

Year-to-date Performance, by Sector: August 21st, 2018

U.S. Markets	Close	Net	1 Day %	YTD %
Dow Jones	25758.69	89.37	0.35%	4.21
Dow Jones Transports	11361.86	134.06	1.19%	7.06
Dow Jones Utilities	740.03	-3.93	-0.53%	2.30
S&P 500	2857.05	6.92	0.24%	6.86
S&P 400 Midcap	2018.44	8.25	0.41%	6.20
S&P 600 Smallcap	1076.42	3.83	0.36%	14.97
NASDAQ	7821.01	4.68	0.06%	13.29
Russell 2000 (Smallcaps)	1698.69	5.75	0.34%	10.63
BKX (Banking)	110.52	0.47	0.42%	3.57
BTK (Biotech)	5071.66	-7.37	-0.15%	20.12
XOI (Oil Index)	1465.51	12.35	0.85%	9.73
SOXX (Semiconductor)	1322.10	-1.32	-0.10%	5.51
XAU (Gold/Silver)	66.11	0.19	0.29%	-22.47

Source: Jeffrey Saut, Raymond James

Asset Allocation 2.0: Fixing Fixed Income

The MAAM investment team recently participated in an event sponsored by Putnam Investments. The subject was fixed income investing and lots of interesting things were discussed. Initial impressions, as well as, those following the event were dominated by the implications of rising interest rates on traditional fixed income investments. Putnam's Chief Investment Officer Bill Kohli did a great job of explaining why, following years of artificially low interest rates, fixed income markets are going through somewhat of a market-oriented debate.

We do too…

When investors attempt to value fixed income instruments they are ultimately calculating the value of future cash flows discounted to today. A broad array of tools and techniques ranging from sophisticated "super computers" to notes scribbled onto the back of a napkin define fixed income analysis. The MAAM investment team views "super computers" as expensive, prone to crashing and always in need of pricey "updates". On the other hand a rudimentary analysis done on the back of a napkin is fine when comparing winter tires but too crude to be used in managing one's savings. Accordingly, we view the valuation of fixed income securities as the sum of three important components: a real rate of interest, an inflation premium and some form of a term-premium to compensate investors whose cash flows are much further off in the future.

The Economic demise of the Ming Dynasty centered in a spike in Silver prices, will rising yields take the lustre off your fixed income portfolio?

A good approximation for the real rate of interest is 2-3%. So too is an inflationary premium of 2-3% given that, since the Ming Dynasty, inflation has run at 3% [talk about a long-term perspective]. Finally, let us use a term premium of 2-3% and then sum up these three components using the more conservative lower end of each range. The 6% figure one derives certainly seems like a long way from where interest rates are today, but the bond market is already giving off signals that it is worried.

Are you worried?

Market oriented debates in the bond market (today) centre on *which* approach one should take with one's allocation to the class not *whether* interest rates will rise or not. Minor corrections in the bond market to us suggest that a bond bear may very well be looming. The Putnam team studied six post Lehman Brothers periods in which interest rates rose by more than 50 basis points (0.5%) and mapped out their impact on the Bloomberg Barclay's Aggregate Bond index a large bond benchmark in the United States. Most investors probably understand that rising rates can adversely impact fixed income holdings because future cash flows are discount more **aggressively,** but we do not think that *all* investors appreciate that rising rates are already having deleterious affects on their capital.

To help show that Canadian investors are not immune to a bond bubble we took a look at the performance of two Canadian bond ETFs during the same periods studied by Putnam to see whether Canadian investors should be concerned and for-the-record the dates are: November 27th, 2009 until April 6, 2010, October 8th, 2010 until February 10th, 2011, May 3rd, 2013 until September 5th, 2013, January 31st, 2015 until June 10th, 2015, July 6th, 2016 until December 20th, 2016 and September 7th, 2017 until May 17th, 2018. The ETFs we chose were the iShares Core Canadian Bond ETF [XBB] and the Vanguard Canadian Aggregate Bond ETF [VAB]. XBB tracks the FTSE TMX universe while VAB specifically tracks a Bloomberg Barclay's index. Our analysis did not require a super computer though it did require some help from a Thomson Reuters terminal but still serves to illustrate two salient points which we will get into in a moment. For now, have a peak at the results:

November 27th, 2009 until April 6th, 2010

RIC	Name	Price Return (Holding Period %)	Total Return (Holding Period %)	Difference (Auto)	Total Return (Annualized %)	Price Return (Annualized %)	CCY
XBB.TO	iShares Canadian Universe Bond Index ETF	-3.2967	-1.1481		-3.2527	-9.1533	CAD
VAB.TO	Vanguard Canadian Aggregate Bond Index ETF	0.0000	0.0000	1.1481	0.0000	0.0000	CAD

October 8th, 2010 until February 10th, 2011

RIC	Name	Price Return (Holding Period %)	Total Return (Holding Period %)	Difference (Auto)	Total Return (Annualized %)	Price Return (Annualized %)	CCY
XBB.TO	iShares Canadian Universe Bond Index ETF	-3.3926	-2.1349		-6.2688	-9.8365	CAD
VAB.TO	Vanguard Canadian Aggregate Bond Index ETF	0.0000	0.0000	2.1349	0.0000	0.0000	CAD

May 3rd, 2013 until September 5th, 2013

RIC	Name	Price Return (Holding Period %)	Total Return (Holding Period %)	Difference (Auto)	Total Return (Annualized %)	Price Return (Annualized %)	CCY
XBB.TO	iShares Canadian Universe Bond Index ETF	-5.8431	-4.8385		-13.6734	-16.3475	CAD
VAB.TO	Vanguard Canadian Aggregate Bond Index ETF	-5.8824	-4.8703	-0.0318	-13.7589	-16.4508	CAD

January 31st, 2015 until June 10th, 2016

RIC	Name	Price Return (Holding Period %)	Total Return (Holding Period %)	Difference (Auto)	Total Return (Annualized %)	Price Return (Annualized %)	CCY
XBB.TO	iShares Canadian Universe Bond Index ETF	-4.5067	-3.6094	-0.2509	-9.7812	-12.1131	CAD
VAB.TO	Vanguard Canadian Aggregate Bond Index ETF	-4.1979	-3.3585		-9.1222	-11.3150	CAD

July 6th, 2016 until December 20th, 2016

RIC	Name	Price Return (Holding Period %)	Total Return (Holding Period %)	Difference (Auto)	Total Return (Annualized %)	Price Return (Annualized %)	CCY
XBB.TO	iShares Canadian Universe Bond Index ETF	-5.1164	-4.0538		-8.6693	-10.8711	CAD
VAB.TO	Vanguard Canadian Aggregate Bond Index ETF	-5.4641	-4.3363	-0.2825	-9.2574	-11.5851	CAD

September 7th, 2017 until May 17th, 2018

RIC	Name	Price Return (Holding Period %)	Total Return (Holding Period %)	Difference (Auto)	Total Return (Annualized %)	Price Return (Annualized %)	CCY
XBB.TO	iShares Canadian Universe Bond Index ETF	-2.3995	-0.4871		-0.7087	-3.4760	CAD
VAB.TO	Vanguard Canadian Aggregate Bond Index ETF	-2.4642	-0.6087	-0.1217	-0.8855	-3.5692	CAD

Firstly, do not allow VAB's greenness in the first few screen shots fool you. VAB did not avoid losses in 2010 and 2011 it just was not around in 2010 and 2011. We imagine that if VAB were around back then, it would have experienced the same fate that other benchmark centric fixed income portfolios did too. Secondly, focus on what the bond market is telling you:

Canadians may think they dodged the Bond Bubble, they'd be well advised to think again

Interest rates are rising and benchmark approaches to fixed income are falling...the end.

In a post Lehman Brothers world dominated by artificially low interest rates there is no debating that interest rates have only one way to go. There is also no disputing the fact that American *and* Canadian investors should worry. Thus, fixing one's fixed income allocation is more about speaking to your Manager and the kinds of fixed income exposure you have and less about frantically exiting all bonds that you own. Private label and non-benchmark fixed income allocations that focus on things like supply chain finance and high-quality bank loans pay investors to wait and provide more durability against rising rates. We utilize this active approach to fixed income in the new MacNicol Alternative Debt Fund and pop the stereotype [and danger] of modern fixed income investing.

Fixing fixed income is all about changing the way people think about conventional approaches to fixed income. At MAAM we think about fixed income differently and we hope you do too.

Times they are a changing [and interest rates are too] shouldn't your approach to fixed income change too?

The MAAM Investment Team

***Roasted* Turkey anyone?**

We love roast turkey: we use it in sandwiches all the time and enjoy its mouth-watering flavour outside of traditional turkey eating holidays like Thanksgiving. Turkey is also a versatile meat that goes great on salads and in delicious turkey burgers. Turkey's stock [in our opinion] is trading on a high.

Turkish stocks have been enjoying somewhat of a rally in recent sessions as global investors have been buying routed positions. Maybe it is the fact that the assets denominated in Lira (which itself spent the majority of June and July in free fall) represent good "value"? The Lira was moderately weaker in the first half of 2018 but the same can be said about a lot of currencies quoted in US Dollars. The LIRA's "nose dive" began when Turkish President Erdoğan appeared in a Bloomberg interview in which he pledged to take more control over the Central Bank of Turkey or CBT. Currency markets wasted little time reacting.

To be clear the MAAM investment team holds no Turkish assets [stocks or Liras] and we fully support a line clearly separating of Presidents and Central Bankers. In Turkey's case we would be happy with a blurred line. But remember, in President Recep Tayyip Erdoğan, investors are dealing with someone with almost "Sultan" like powers who (already) asserts significant overbearance in many aspects of Turkish life. Erdoğan has his finger on things like the media, the judiciary and obviously domestic and foreign policy matters. That he would commandeer the CBT though is somewhat of a puzzle to us. The Turkish economy is large and strategically important and its land is one of the longest continually inhabited parts of the world but the nation's capital markets are still very much part of the “minor league” emerging market complex. Turkish investment capital is far more beholden to global market forces than CBT policy be it genuine or contrived. As such, despite the recent turn around in Turkish stocks and some early stage signs of a resurgence in the Lira, the MAAM investment team believes the prevailing trend (for both) is lower. As it pertains to recent CBT policy measures, we believe they either met or did not meet their intended objectives: Lira rebounds of late probably had more to do with higher funding rates facing lenders and the substantially higher costs associated with shorting the Lira at current levels. Regardless of day-to-day movements in Turkey’s stock market or currency, the overall implications of the actions by President Erdoğan are alarming. For what its worth though the Lira's near-term volatility more closely resembles a cryptocurrency than a fiat currency.

And about those “valuable” Turkish stocks…

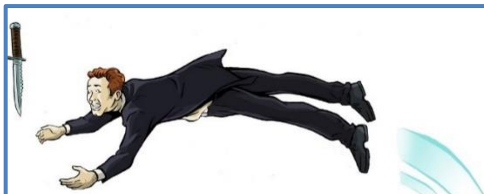
[McTurco anyone?]

One analyst we follow recently noted that the market capitalization of McDonald’s is bigger than the *entire* Turkish stock market. McDonald’s is hardly a small company, but it is 7.3x smaller than online retail juggernaut Amazon. We don’t know if President Erdoğan’s unusual brand of public relations did much to help the situation: blaming nefarious foreign players for waging an economic war does little to instill investor confidence.

For weeks many figure heads in the industry and from the world of politics suggested that the situation in Turkey would not deteriorate materially…or spread.

We think the situation in Turkey has the potential to severely damage Emerging Market sentiment.

And be mindful of preaching on the part of Turkish officials. Erdoğan appointed his son-in-law Berat Albayrak in a role tantamount to that of a National Finance Czar.



Never catch a falling knife

Turkey’s top finance official is: a business school graduate, a former CEO and head of the Nation’s Energy Ministry…but he’s also just 40 and easily out classed by many other financial gurus at President Erdoğan’s disposal. In appointing Albayrak, President Erdoğan exposes himself to allegations of nepotism and ongoing accusations of autocracy.

Still, Albayrak did not mince words when attempting to reassure investors that CBT independence was of the utmost importance:

"The independence of the central bank and its decision-making mechanisms cannot be a subject of speculation"

"One of the main aims of our policies in the new period is a central bank that is effective like never before"

- Berat Albayrak

Currency markets obviously disagreed…oh and credit ratings agencies did too.

Fitch downgraded Turkey's debt and Moody's had this to say about the scrum: *"Any perception of encroachment into the independence of a central bank and other public institutions will likely exacerbate investor concerns"*, which of course was the case as the Lira tanked further.

Just how many German, French and Italian Banks hold Turkish debt?

For a crisis framed as "contained" German Chancellor Angela Merkel and President Erdoğan sure have been seeing a lot of each lately.

We obviously do not know at this very moment how many European banks hold Turkish debt, but we assume that given the country's size and economic diversity it is a safe bet that the answer is more than just a couple.

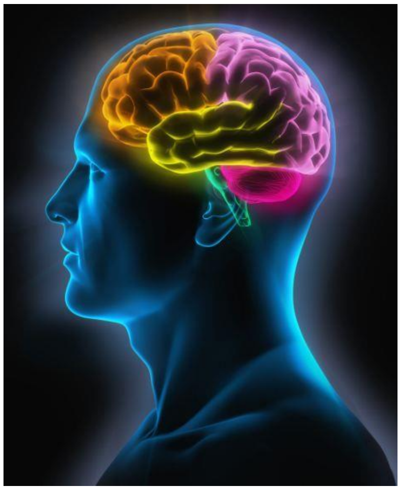
We also note that German Chancellor Angela Merkel felt sufficiently compelled to issue a call directly to Erdoğan about the situation. Perhaps Chancellor Merkel took the opportunity to advise Erdoğan that any positives gained from bringing outsiders into the Turkish administration are a veneer clouding the polarizing nature of his management style, which is increasingly harsh towards those seen as ideologically or politically opposed to either him personally or his party.

Turkey is not a "page 1" news story and we advise investors to focus on themes with even broader implications like China. But in an increasingly inter-connected global world, a country with Turkey's finances can ill afford to alienate foreign investors. Turkey's deficits along with Erdoğan's basic misunderstanding of how interest rates work is a recipe for disaster.

Toss in capital controls and asset seizures and Turkey's goose is cooked.

Fear Not

Recently the MAAM investment team observed a higher rate of investor anxiety that is associated with not being anxious enough. We have spoken to many investors recently and the barriers to investing were by-and-large the same: valuations, trade wars, Turkey, rate hikes or what Trump will do next were common concerns on any investor "Top 5" list. So why are we on the one hand so relaxed yet cautious? At MacNicol and Associates Asset Management we are Active Managers who take time to carefully select a basket of conventional and alternative assets that are designed to work well and compliment each other over time. We also invest gradually not all at once. The ease with which we approach investment opportunities or the investors that we help should never be interpreted as us being languid towards the safety of our investment harbour. Rather, it is because we are cautious that allows us to sleep so well at night.



My goodness, I've run out of things to worry about.

Investment markets globally have endured many set backs over the years and perhaps the recent spike in anxiety we observe signals that scar tissue from the global financial crisis still exists. But it should certainly not cause investors to abandon investing in their future. After all the primary reason for investing today is to save for tomorrow and grow one's capital at a rate that more than offsets inflation.

We are certainly not suggesting investors blindly pile into the latest momentum-based ETF but we are also cautioning investors on the impacts of being under invested. Over short-term periods a cash overweight is fine but longer term, it can materially impact your overall financial goals. Cash simply doesn't compound at high enough a rate to be useful in a broader portfolio context.

At the end of the day if you or someone you know is worried but not quite sure about what, please, have them speak to us first. We have been helping investors smooth out stormy waters [both actual and perceived] for nearly two decades.

Firm News

MacNicol & Associates is pleased to announce that our Facebook page is up and running and compliments new content to our revised website.

Fall 2018 conference planning continues but will be held in Toronto and additional cities in future years.

Congratulations to Abdullah Chandna one of our sister company's research Analysts. Abdullah recently passed the first CFA examination earlier this summer.

Congratulations also go out to David MacNicol Jr. who completed the grueling Lake Placid Ironman race in July, finishing in 11 hour and 36 minutes and well below his estimated 12 hour completion time. David Jr., competed in the event on behalf of the www.jack.org charity and will take a well earned rest before he sets off for Medical School. Well done David Jr.!

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