September 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.

"You do not want to give Jeff Bezos a 7-year head start"

- Warren Buffet

The Numbers:

Index:		**Year-to-Date:**
S&P/TSX:		-4.51%
NASDAQ:		15.82%
Dow Jones:		5.08%
S&P500:		8.04%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	1.50%	2.13%
5-Year Bond:	2.16%	2.74%
10-Year Bond:	2.23%	2.87%
30-Year Bond:	2.24%	3.05%

Economic Data:

- The Bank of Canada keeps key interest rate unchanged
- US economy adds 201,000 jobs in August with avg. hourly earnings growth [2.9%] stoking fears of tighter US monetary policy despite "whatever it takes" reference by US Fed Chair Powell earlier in August
- US Mid-term elections approach while global trade rhetoric moderates slightly against grumblings of impeachment
- Gold briefly below $1,200 in August but gains ground on short covering
- Central Banks add to their bullion reserves in August
- Crude pulling back from $70 on inventory build up
- Argentina and Turkey renew contagion worries
- Crude Oil off from $70 peak on inventory build

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	24.98	23.28
P/B: Price-to-Book	3.46	3.05
P/S: Price-to-Sales	2.29	2.08
Yield: Dividend Yield	1.77%	1.93%

Year-to-date Performance, by Sector: September 6th, 2018

U.S. Markets	Close	Net	1 Day %	YTD %
Dow Jones	25974.99	22.51	0.09%	5.08
Dow Jones Transports	11386.73	67.24	0.59%	7.30
Dow Jones Utilities	739.62	8.72	1.19%	2.25
S&P 500	2888.60	-8.12	-0.28%	8.04
S&P 400 Midcap	2038.55	-1.91	-0.09%	7.26
S&P 600 Smallcap	1091.76	-1.82	-0.17%	16.61
NASDAQ	7995.17	-96.07	-1.19%	15.82
Russell 2000 (Smallcaps)	1727.65	-5.73	-0.33%	12.51
BKX (Banking)	110.91	0.05	0.05%	3.94
BTK (Biotech)	5284.16	-15.28	-0.29%	25.15
XOI (Oil Index)	1496.59	-5.93	-0.39%	12.06
SOXX (Semiconductor)	1403.82	-7.11	-0.50%	12.03
XAU (Gold/Silver)	63.07	-0.36	-0.58%	-26.04

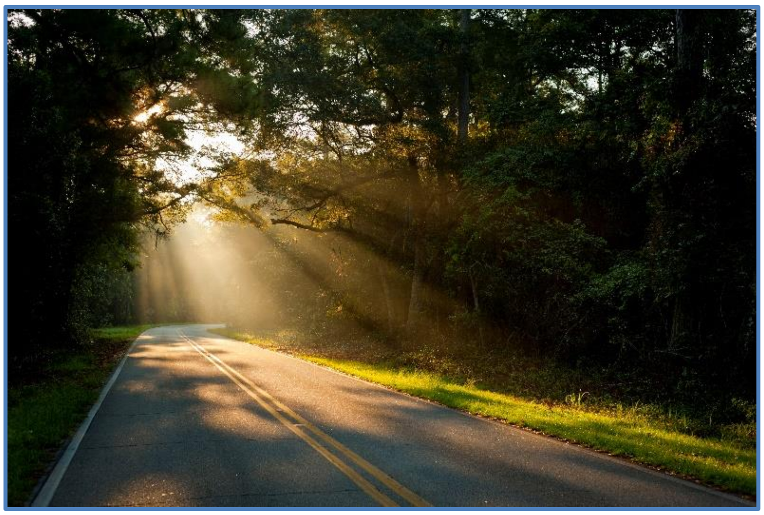
Source: Jeff Saut, Raymond James

Click, click go…the grocery shoppers?

I remember grocery shopping with my Dad when I was younger. The hustle and bustle of a grocery store back in the mid 1980's Mississauga, Ontario was an exciting place for a young boy to be on a Saturday morning. The 1980's were formative years for Mississauga and for me. There were lots of things to see and lots of things to do in a grocery store back then and controlled chaos really is the most fitting way to describe what I experienced. In the lead up to Saturday's "adventure" Dad would comb through store flyers and make note of weekly "specials". Mom would provide updates on our family's inventory of meats, dairy products, fruits and veggies and breads. My younger sister and I would meet to discuss strategies aimed at extracting (extorting) sugary snack approvals from our parents that exceeded the number of approvals granted in previous excursions.

[Oh yes, it's that easy…]

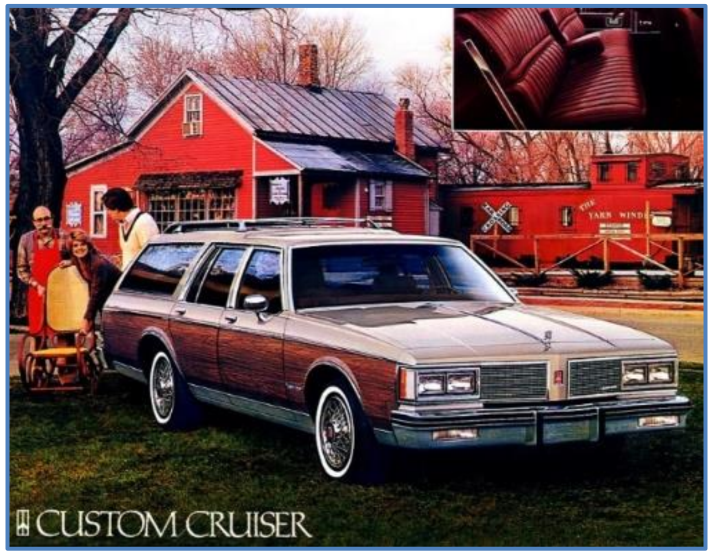
The Stage was set…



During Mississauga's formative years, the 1980's, there was no traffic…roads were big, new and not many families had cars or even a car.

On Saturday morning Dad and I would embark on our journey while Mom and Elizabeth were still in bed. The drive to the grocery store was exciting in its own way. With my Mom and Elizabeth still asleep I got to sit in the (front) seat of Dad's car and scan the road ahead. As we arrived at the grocery store's parking lot, Dad had this knack for always finding just the right spot.

In the grocery store Dad would review everything we selected with meticulous attention to detail. Things like meats and cheese, fruits and veggies, and dairy goods were scrutinized for their *apparent* and *actual* freshness. Apparent freshness was the freshness implied by an expiry date stamped onto a product, which to some consumer was good enough. But for those who don't know my Dad that well please allow me to enlighten you with two itsy bitsy facts about him: Eastern European immigrant to Canada and CRA Auditor (back then CRA was known as Revenue Canada). So "apparent" freshness represented just the first tier of my Dad's overall freshness analysis. *Actual* freshness was ascertained through a more thorough investigation of a product's characteristics and involved a complex series of (seemingly) random sniffs and squeezes. It was embarrassing sure, remember I was little more than a tyke back then, and it evoked a wide variety of glances from other shoppers, the two most popular conveying thoughts of either a) scrupulous shopper or b) complete lunatic. But I wasn't mortified for long, remember, I had a job to do: stating why Elizabeth and I needed an even greater dose of the latest sugary snacks and treats to a naturally perceptive CRA Auditor was something that involved perception and wit. As luck would have it I was fortunate enough to have both and obviously my Mom credits this as her contribution to the gene pool. But I did not wish to take sides in a debate on cranial capacity…all I knew was that if the world came to an end Elizabeth and I would die happy. For his part, Dad did a pretty good job of striking just the right balance between "*it's good for you*" and "*you'll like it*" and as a Father of two myself I can tell you I really appreciated that. But we were a long way from being done, and if you thought Dad was good at separating miscreant meats from magnificent ones, you should have seen him invigilating a cashier's receipt...talk about a "Notice of Audit".



1980's grocery getter complete with wood trim…on the outside. Remember the minivan hadn't been invented yet…"Custom" cruising indeed!

We eventually did make it back into the parking lot where we would load our goods into Dad's station wagon, a brown Oldsmobile (a General Motors brand that sadly went the way of the Dodo bird following GMs bankruptcy) and begin our journey home. I would not frame "the cruiser's" handling as razor sharp but it did offer a cargo capacity that rivaled many of today's full-sized pick up trucks. And hey Oldsmobile invented the automatic transmission...bet you didn't know that. By this point, Mom was well into her "inventory management" protocol back at the house. Moving older food to the front of the fridge so that newly purchased food could be placed in the back fooled us into eating foods proximate to their expiration date first so that if the world really were coming to an end we would have enough food to last us through the apocalypse. It sure was a lot of work on the part of my parents and I will never forget that.

But times have changed…

For one thing the population of Mississauga has grown by a factor of 10 and now rivals that of Ottawa. Lots of Mississaugans also happen to own computers with internet connections and so more and more of them are likely to do their grocery shopping online. As it turns out, so are citizens across the GTA and beyond.

Back in modern day Scarborough my next-door neighbours, a delightful Lawyer and School Teacher couple, are ardent users of grocery delivery services. Cindy and James would not be caught dead squeezing or sniffing food in the isle of a grocery store and delivery trucks are somewhat of a fixture at their place. South of the boarder our American friends have been clicking their fridges and pantries full for years and online grocery shopping predates companies like Amazon or at the very least Amazon's quest for world domination.

In this edition of *The Monthly* we examine at the current state of grocery e-commerce. Consumer preferences in the grocery e-commerce space are evolving rapidly and the industry is in a state of flux. The implications for consumers and investors are huge, and we aren't the only ones interested in learning more about this. BMO Capital Markets recently commissioned a survey of 750 Canadians to gain greater insight into the evolving habits of the Canadian grocery shopper. The survey and subsequent report go on for pages, but the key findings are listed below:

The key findings of the BMO survey are interesting and hold implications for consumers and investors:

Source: BMO Capital Markets

BMO's findings suggest that Canada's main grocery outlets (Metro, Loblaws and Empire) are at a competitive disadvantage against companies like Amazon since Amazon's focus is quick, inexpensive home delivery of *pantry* goods that consumers value. Amazon did acquire Whole Foods earlier but is still years away from offering a wider grocery experience to consumers as they lack the requisite fulfillment capabilities imbued by large warehouses or a fleet of refrigerated trucks. Metro, Loblaws and Empire each have their own approaches towards grocery e-commerce that can be described best as non-homogeneous hybrids. Metro's focus is inexpensive home delivery, an option we see flourishing in places like Mississauga and the GTA thanks to traffic that vaporizes time, frustrates the nerves and begs for an easier way of doing things.

A growing cohort of aging boomers with pour eye sight simply do not drive as much anymore (may-be they are fed up with gridlock) and we can see the delivery option as a real source of value add to them. Loblaws' focus is different and referred to as a "*click and collect*" model. Click and collect is simple: one spouse places an order online and fires off pick up instructions to the spouse with the car. We believe click and collect will appeal to communities with a high density of children that participate in extra curricular activities and who thus must be chauffeured around by Mom or Dad to: hockey, ballet, a second language class, horseback riding lessons or the 50-75 other activities modern parents must pay out of pocket for in order to be considered "good". Loblaws has a home delivery option but it is expensive and out of sink with competing offerings. With Empire, a company that has had home delivery as part of its offering for 20 years in places like Quebec, the focus is on acquiring additional market share through joint ventures. In January of 2018, Empire announced a partnership with Ocado Group to create a fulfillment centre designed to handle 70,000 home delivery orders per week in the GTA. The biggest risk with this strategy is the ongoing fixed cost of a $70 million fulfillment centre against the risk of sluggish consumer demand for delivery. Profitability is a real possibility should capacity utilization be achieved but at this stage its too early to tell. The other factor investors need to consider is capital investments for click and collect services are minimal when compared to delivery options and so we believe a straight “drag race” between Metro and Loblaws based purely on their online strategies is at this stage too close to call. Metro’s strategy can be viewed as reluctant or what corporate executives term “disciplined” in that the company is assessing the landscape before deploying capital to pivot the company more decisively to either channel. Empire and Loblaws have chosen to pursue more specific paths.

We believe return on investment will be awarded to the company with a hybrid approach that meets the right mix of community specific and consumer specific needs so building massive fulfillment centres or employing the slickest artificial intelligence on a website may not in and of themselves translate into immediately accretive earnings contributions.

American’s aren’t standing still either…

Costco and Walmart have also made investments in the online space. If fighting your way through a congested Costco location is something you never look forward to, you now have the option to have your order delivered, but fresh or frozen food items are off the menu. Walmart offers both pick up and delivery options including the companies so called “Penguin” pick up points, which are smaller satellite locations closer to home yet cheaper than having merchandise delivered. It is too early to tell how the grocery e-commerce landscape will play out though the MAAM investment team believes that urban development, demographic trends, consumer preferences and the flexibility of procurement will drive investment capital to channels with the highest rate of capacity utilization. Investors should therefore not necessarily avoid Empire purely because the company is making more significant investments in the e-commerce space where as Metro and Loblaws are tending to favor strategies requiring smaller capital outlays. Grocery e-commerce requires precision analysis, so be aware that while delivery is the preferred method of online grocery shopping today click-and-collect options are rapidly evolving their offering to consumers while at the same time basking in the glow of favorable reviews and higher instances of repeat buying. For what its worth the consumer is the net beneficiary any time companies compete for business and the battle currently underway in the grocery e-commerce space is set to provide consumers with the one thing they value most: choice. In the interest of full disclosure this Portfolio Manager has shopped for food and other products on most of the websites mentioned in this article and he has collected those products himself or had them delivered to his home. He even owns one in the MacNicol Conservative Income Fund he helps run (Walmart) but is unclear as to which company or channel will be the way of the future. Perhaps my work is only just beginning…

The MAAM Investment Team

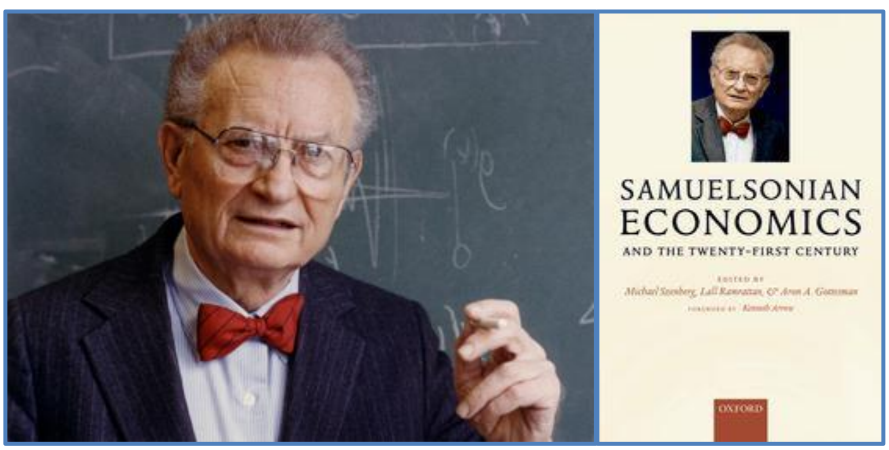
Top of the bottom or bottom of the top?

Famed economist Paul Samuelson, once quipped…

"*The market has accurately called nine of the last five recessions*"

…which is precisely why we are not overly concerned about the recent performance of Emerging Markets …well some of them in any event.

Indeed, some areas of the emerging complex are far worse than others, so it is important for us to point out that the MAAM investment team stands an enormous distance from troubled spots like Indonesia, Chile, Argentina and Turkey in our award winning MacNicol Absolute Return Fund. As a matter of policy, we avoid contentious leadership poised to take a country back in time instead of moving it forward. Being skeptical seems to work well in the Emerging Markets and this isn't us taking a "victory lap" either. The risk of contagion or even the simple *perception* of the risk of contagion can scare off investment capital and severely erode returns.



So, what do we think about Emerging Markets overall?

First off, we do not think about Emerging Markets broadly, as one asset class, we think about them specifically. These are individual country specific investments each with its own reason for making it into a portfolio and each with its own growth story to tell. Those stories matter a great deal and country selection matters, so make investments in areas with reform minded leaders and pro-business attitudes. We think they will perform much better than those that are increasingly autocratic, authoritarian or just plain ignorant. Thus, a beliefs-based framework should shield you from a lot of the carnage and help your portfolio grow. We fall short of suggesting that one political ideology is better for investments than another but the way we see it, countries either want to do business with the rest of the world and grow, or they don't. As far as the carnage goes, we believe it is over for the time being and for nations that want to "play ball". Accordingly, in our view, many nations, such as India represent good value. But our rationale extends beyond the observation that

Emerging Markets have been pummelled. The US dollar index spent most of the Summer rising on US Fiscal and Trade rhetoric and is now at some kind of precipice that we feel may expose it to a bit of a correction. Developments in US Trade talks highlight a slightly less adversarial tone on the part of President Trump and the intonation in his communications suggests to us that perhaps he understands that he cannot necessarily win a Trade War with nations prone to devaluing their currencies. Of course, with Donald Trump things can change by the minute but we believe the President knows that heading into a mid-term election campaign a de-escalation of trade tensions will avoid a situation where additional tariffs will drive US consumer prices higher and force the Federal Reserve to become more Hawkish that might otherwise be necessary. Remember, the President wants to be in control and even the perception that his trade platform is ineffectual will reduce his credibility and approval ratings. Progress with China and a NAFTA deal allow the President to "sell" a good news story to the American people and we hope that may reduce US Dollar strength at a time when an extremely wide divergence exists between US and Emerging Market investments.

To summarize, the MAAM Investment Team absolutely regards several Emerging Markets as representative of good value and we view those markets as something few portfolios should be without. At the same time, we caution that US mid-term elections are not preconditions for US Dollar moderation. Rising corporate profits, record buybacks and a market that just wants to go higher will likely propel US stocks for the foreseeable future, and this is also bullish for the greenback.

So be vigilant and speak with us before taking your portfolio overseas.

Thoroughness is next to Godliness when it comes to investing

"*Yes, I can see that but its important to be thorough, especially when a man dies alone*", Lt. Columbo (aka Peter Faulk)

In recent weeks, the MAAM Investment Team observed an interesting phenomenon in our discussions with investors. We thought we would share our observation with you because we believe it has an awful lot to say about investor psyche and how markets can influence it. Rather than investors waiting for the market to convince *them* something is wrong with-it investors appear to be trying to convince *the market* that something is wrong *with it*.

The story goes something like this:

Prospective Investor: "Dear MAAM Investment Team, thank-you for taking the time to listen to my needs and present to me a detailed overview of your firm and how it has helped investors for nearly two decades". "I really think your firm has my best interests at heart, but I am a little nervous investing right now".
MAAM Investment Team: "Mr. and Mrs. Investor it was our pleasure getting to know more about you and telling you our story". "We would be delighted to have you as our new client but what troubles you…what is at the root of your investment anxiety"?
Prospective Investor: "Nothing in particular...corporate profits are rising; the economy is doing well, and I feel pretty good about my overall financial situation".
MAAM Investment Team: "So what is it then"?
Prospective Investor: "Well it's just that it has been ten years since the markets last took a turn for the worse and I feel we may be overdue for another large correction or unpleasant Bear Market". "I was only 56 years old back in 2008 and while a decade has passed, I remember how I felt about my investments a decade ago and it was not pleasant...not pleasant at all".

Bull Markets never die of old age but if this one does it certainly will not be alone…so be thorough

Despite having traversed a steep and lengthy grade since the global financial crisis market breadth or the number of stocks participating in moving the market higher overall is increasing. So, the notion that capitalization weighted indices are being pulled higher by a small number of gigantic technology stocks is misinformed. Raymond James Chief Market Strategist Jeff Saut recently raised another extremely important point that augers for a new or better perspective. Perhaps investors should view this Secular Bull Market in equities as having began in the Spring of 2013 when markets broke through their previous highs as opposed to some point between the fourth quarter of 2008 and the first quarter of 2009. There are several other ways to look at the market from a glass is half full perspective. Worrying about one's capital is natural especially when you believe you have missed the boat or are approaching retirement. But keep in mind the MAAM process will anchor your portfolio's foundation safely so that it can capitalize on growth at home and abroad. Prudent investing is far from just a marketing line for us, its a way of life. Scar tissue abounds even a decade after the collapse of Lehman Brothers but despite the supposedly elongated length of the market cycle, we do not see four horsemen on the horizon. As always, we will stay true to our discipline of safe harbour investment and monitor what is most important to you.

The earliest account of the Four Horsemen of the apocalypse is described in Bible's *Book of Revelations*. In that book, the quorum of horsemen is described as symbolic of pestilence such as the bubonic plague. Pop culture has adopted a bewildering array of interpretations of the Horsemen to suit Hollywood film studios and makers of video games. Not only does the MAAM Investment Team not see the horsemen over the investment horizon, but we do not view them as harbingers of anything that could have a lasting, damaging impact on global stock markets.

The MAAM Investment Team

Firm News

September truly is the most wonderful time of the year (when you're married to a Teacher and have two small children). Witty puns aside, this Portfolio Manager is delighted to report that Mrs. Portfolio Manager and our two "junior" Portfolio Managers returned to the classroom earlier in the week. All are doing well and excited for what the new school year has in store.

David and Diane accompanied David Jr., to Saba Island where he embarked on his journey to become a Medical Doctor at the Saba University School of Medicine. The school is widely regarded and a focal point of the local economy.

MacNicol & Associates Asset Management Inc.