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*December 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 do not like broccoli, and I haven't liked it since I was a little kid and my mother made me eat it. And I'm president of the United States, and I'm not going to eat any more broccoli."*

- George H. W. Bush, 41st President of the United Sates

***The Numbers:***

| **Index:** | | **Year-to-Date:** |
|---|---|---|
| S&P/TSX: | | -5.89% |
| NASDAQ: | | 5.36% |
| Dow Jones: | | 2.51% |
| S&P 500: | | 2.40% |
| **Interest Rates:** | **Canada** | **USA** |
| 90-Day T-Bill: | 1.70% | 2.37% |
| 5-Year Bond: | 2.21% | 2.83% |
| 10-Year Bond: | 2.27% | 3.02% |
| 30-Year Bond: | 2.40% | 3.31% |

**Economic Data:**

- Canadian manufacturing PMI higher in November
- Commodities sharply lower during first half of November now forming a recovery
- November auto sales lower for 9th month in a row as higher rates begin to impact car dealerships
- Bank of Canada likely on hold given the situation in Alberta despite higher inflation readings in November.
- US Fed Chair Powell eases Hawkish position during speech at the New York Economic Club
- Trump trade tiff with China (temporarily) on hold

**Valuation Measures: S&P 500 Index**

| **Valuation Measure** | **Latest** | **1-year ago** |
|---|---|---|
| P/E: Price-to-Earnings | 15.7 | 24.3 |
| P/B: Price-to-Book | 3.3 | 3.2 |
| P/S: Price-to-Sales | 2.2 | 2.1 |
| Yield: Dividend Yield | 1.88% | 1.84% |

**Year-to-date Performance, by Sector**: November 30th, 2018

| U.S. Markets | Close | Net | 1 Day % | YTD % |
|---|---|---|---|---|
| Dow Jones | 25338.84 | -27.59 | -0.11% | 2.51 |
| Dow Jones Transports | 10679.80 | -86.81 | -0.81% | 0.64 |
| Dow Jones Utilities | 729.08 | -1.01 | -0.14% | 0.79 |
| S&P 500 | 2737.76 | -6.03 | -0.22% | 2.40 |
| S&P 400 Midcap | 1866.74 | -2.22 | -0.12% | -1.78 |
| S&P 600 Smallcap | 956.63 | -4.48 | -0.47% | 2.18 |
| NASDAQ | 7273.08 | -18.51 | -0.25% | 5.36 |
| Russell 2000 (Smallcaps) | 1525.39 | -5.00 | -0.33% | -0.66 |
| BKX (Banking) | 100.52 | -0.86 | -0.85% | -5.80 |
| BTK (Biotech) | 4724.61 | -31.37 | -0.66% | 11.90 |
| XOI (Oil Index) | 1307.65 | 6.68 | 0.51% | -2.09 |
| SOXX (Semiconductor) | 1221.43 | -10.02 | -0.81% | -2.52 |
| XAU (Gold/Silver) | 64.80 | -0.73 | -1.11% | -24.01 |

Source: Jeffrey Saut, Raymond James

**Foreign Exchange - FX**

We continue to survey all the Banks and some Custodians to compare Foreign Exchange Rates charged. As you can see in the chart below some of these Institutions are charging considerably more than last month when we did our first comparison. Could it be they are trying to further profit from Holiday travel and purchases in US dollars? We tried to include some other firms but they do not post public rates online or require a membership fee. Let us know if we have left any organization off here and we will try to include in future publications.

| As of December 5, 2018 11:30 AM | $ 5,000 | Cdn | | |
|---|---|---|---|---|
| **Banks** | Rate | **Buy USD** | **Cost** | **% Difference from Spot Rate** |
| CIBC | No Public Rate Posted Online | | | ??? |
| Interactive Brokers | 1.3369 | $ 3,740 | $ (44) | -1.2% |
| Laurentian Bank | No Public Rate Posted Online | | | ??? |
| National Bank | 1.3477 | $ 3,710 | $ (74) | -2.0% |
| Raymond James | 1.3215 | $ 3,784 | $ - | 0.0% |
| Royal Bank | 1.3660 | $ 3,660 | $ (123) | -3.4% |
| Scotia | 1.3734 | $ 3,641 | $ (143) | -3.9% |
| TD | 1.3709 | $ 3,647 | $ (136) | -3.7% |
| **Spot Rate** | 1.3215 | | Best Rate | 0.0% |

***Picked apart…?***

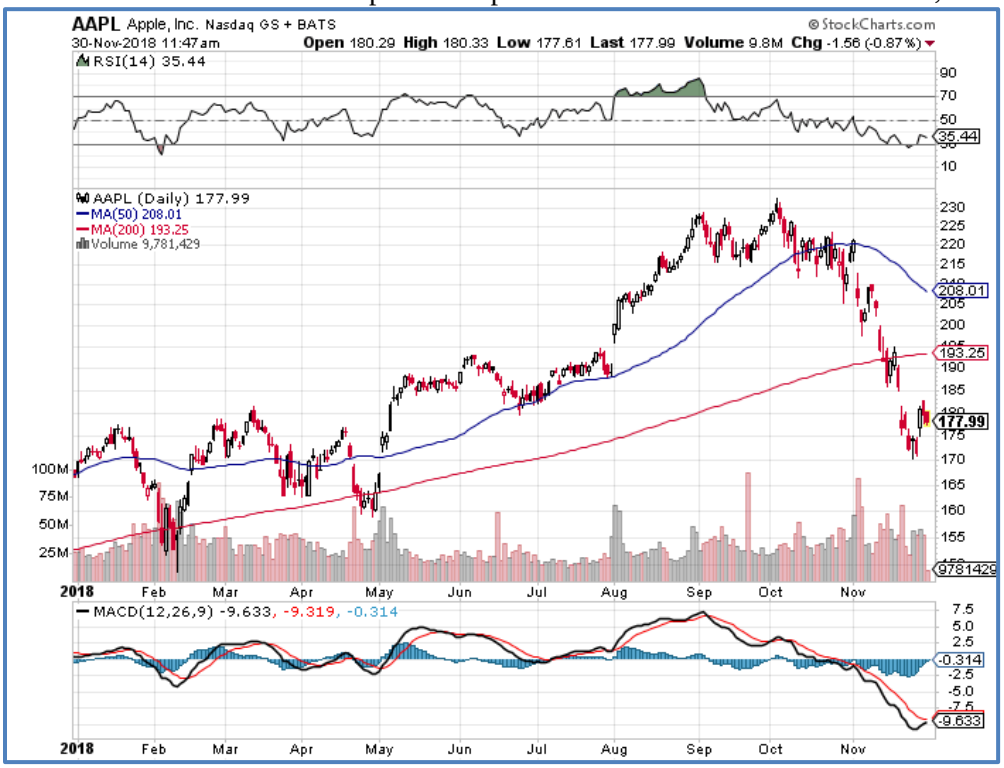
My wife loves Apple computers and iPhones, an assortment of iPods and one of those Apple docking stations that can fill an entire room full of music also reside at our home. Years ago, purely as a token of my affection, I went into an Apple store in Newmarket and bought Maria the nicest computer I could afford. Back then the market was doing reasonably well also and the thought of losing one's savings was hardly a deterrent to new business. Clients could not get enough of me and at 30 years of age I was managing money for people who senior to me in more ways than one. These people were not the Rockefellers, Warren Buffet or Bill and Melinda Gates but they were families who created businesses that helped shape the fabric of Ontario. In a handful of cases, I oversaw a small fraction of the total wealth these families had. Intangibles such as buildings or entire sections of roadway named in their honor helped me quantify the fact that I barely knew the difference between preferred stock and livestock back then mattered little and the silly logo the bank made us wear on our suit jackets mattered even less. Back in those days Apple was the must have product to put under your tree and the must have stock to put in your portfolio. That Apple products were on average twice the price of comparable products that were just as good was a point consider only the most punctilious of tech heads. In the mid 2000s it was Apple, or it was nothing. I paid cash for the computer, a fair bit of cash. I never said I felt good about handing over a beefy stack of $20 bills (powerful may-be) but remember this was a gift for my wife and thus captured under the banner of "*it is better to give than to receive*". Maria just loved her new computer

and uses it until today, but time has soldiered forward, and the once cutting-edge unit is starting to show its age…. but more on that in a moment.

For the last couple of years jogging has been my main work out routine. I run a fair bit, but I am a long way from being a naturally gifted runner or someone with the determination needed to run a distance one would generally drive but running keeps me healthy and fitter than your average Bay Street Portfolio Manager. Running also keeps me surly so quite frankly running stinks. Its hard to prepare for, painful to recover from and unimaginably boring to do. Fortunately, I happen to live in a beautiful part of Scarborough...but it is a part of Scarborough I have now traversed by foot for the better part of a decade: these are streets, parks and forests I have seen before and thus a quality music player is almost compulsory for running. Having bought my fair share of music players over the years I can tell you the difference between the good and the bad for you and it is a big difference. The uninitiated may view the ubiquitous "iPod" as the worlds first truly portable music player, but that distinction goes to a company called Creative. Creative made some truly magnificent products over the years including an MP3 player that I ran over with my mountain bike years ago, but which kept right on playing. Sadly, for a lot of companies like Creative the freight train that was the Apple steam rolled ahead with no end in sight. My own journey into married life saw a part of me overwhelmed by the Apple brigade and need to “keep the peace” at home.

As history shows so too did millions and millions of consumers...

Back on August 4th, 2018 Apple became the world's first Trillion-dollar company and no that isn’t a typo. Putting Apple’s peak in perspective was easy: line up seven companies the size of Toronto-Dominion Bank and toss in a small sized insurance company for good measure and you pretty much had your comparison. To me the peak valuation in Apple’s stock (which accelerated even higher until October) represented the beginning of the end, and ratios or complex financial models had nothing to do with my view. The MAAM investment team on the other hand is obsessed with complex financial models but mainly we are convicted in our time-tested process of safe harbour investing. So, our decision to buy shares of Microsoft in client portfolios proved to be the safer bet to make. So, what went wrong with Apple? Well let’s first look to an account from the *Wall Street Journal* then I will fill you in on my take. The *Wall Street Journal* warned that Apple cut production over the past several weeks for all three of the new iPhone models.




*"Lower-than-expected demand for Apple’s new iPhones and the company’s decision to offer more models have created turmoil along its supply chain and made it harder to predict the number of components and handsets it needs”.*

*- Wall Street Journal*

Apple is still a gigantic company, but the stock has lost around $85 billion in market capitalization since it peaked at an eye watering $1.121 Trillion on October 3rd, 2018. To put $85 Billion in perspective is easy too: find every single last share of Starbucks and you'll have found $85 Billion.

We do think that demand issues are finally catching up to a stock whose valuation seemed to know no upper limit. Apple had saturated consumers with its products and muscled out further price increases in the iPhone and other iProducts.

We also noticed that Apple recently ceased reporting unit sales or made them so darn hard to find that people with Engineering Degrees or CFAs were kept in the dark. A "unit" is a product line of which Apple has four: iPhones, iMacs, iPods and iPads (i.e. phones, personal computers, music players and tablets). If a macro narrative presaged slowing demand for some of the world's most important consumer products, then I think investors have a right to know. Sure, some investors will want to focus on the "big picture" and that's not a bad thing but those same investors shouldn't forget that it's really the iPhone and not some music player I wear around my wrist whilst jiggling down the road on my run that took this company to a trillion dollars in the first place. One perceptive Doctor client of ours in the West end recently inquired about whether the pull back in Apple's share price [a solid fifty bucks] represented a good entry point. It may very well be but as we have opined before the job of a Portfolio Manager is not to provide unflappable clairvoyance its getting a strong understanding of what matters to you and your family and what types of risk you can take. Still when asked a question we respond and in this case a picture is worth a trillion words. Technically Apple has been beat up badly, so the charts don't exactly signal to us an "all clear". Moreover, untold numbers of gigantic hedge funds and ETFs that have exposure to this broken-down tech giant could have selling programs in place that may last months. Whether protecting year-to-date gains or taking an end-of-cycle view, the brain trusts in New York, Greenwich and London are likely poised to dish out more pain on the stock.

RECOMMENDATION SUMMARY

| | Analysts Per level | | | |
|---|---|---|---|---|
| | 30-Aug-2018 | 30-Sep-2018 | 30-Oct-2018 | Current |
| 1 - StrongBuy | 14 | 15 | 17 | 14 |
| 2 - Buy | 13 | 13 | 13 | 11 |
| 3 - Hold | 14 | 14 | 13 | 16 |
| 4 - Sell | - | - | - | - |
| 5 - StrongSell | - | - | - | - |
| **Rec Mean** | **2.0** | **2.0** | **1.9** | **2.0** |

PRICE TARGET SUMMARY

| Price Target | Target | | | |
|---|---|---|---|---|
| | 30-Aug-2018 | 30-Sep-2018 | 30-Oct-2018 | Current |
| Median | $219.00 | $237.50 | $242.00 | $225.00 |
| Mean | $216.99 | $234.77 | $239.75 | $230.63 |

**Bay and Wall Street Analysts were raising their bets on Apple as recently as Halloween. Since the latest batch of phones were released though price targets have been revised lower with some Analysts recommending investors think twice about the stock.**

In case I was not clear I have never been a big fan of Apple; their products are good but certainly not worthy of an exorbitant price premium. I resent having had to pay more for a computer back then and I resent having to consider that same dilemma today. A 27" iMac currently lists for $2,300 in Canada and click yes to a bunch of pointless add ons can easily take that price to an even $3,000. The average American or Chinese really doesn't need another $1,000 iPhone. The average investment portfolio doesn't need shares of Apple. And this Portfolio Manager can show affection to his wife in many ways that do not involve handing over a huge stack of bills.

**The MAAM Investment Team**

**"Ho, ho, ho" Merry Christmas from all of us at the US Federal Reserve, "Santa" Jerome.**

**The difference between "just below" and a "long way from" neutral?**
**About 2.5%…**

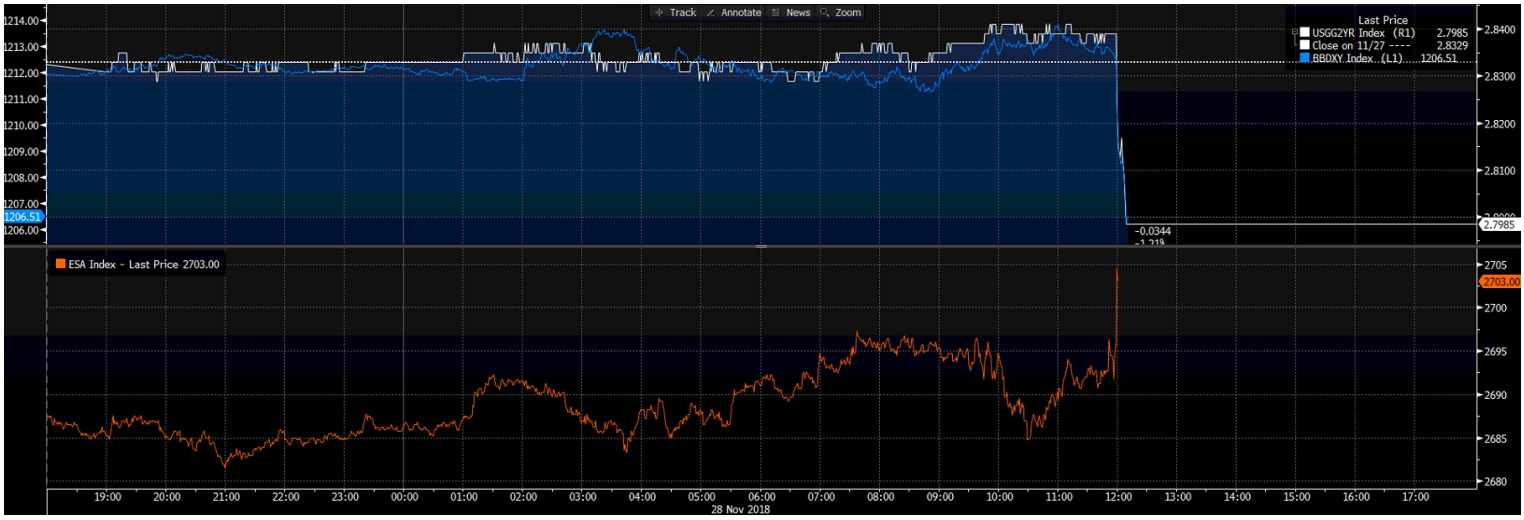
Regular readers of *The Monthly* know that US President Donald Trump isn't exactly a huge fan of US Federal Reserve Chair Jerome Powell. Trump thinks that Powell is raising US interest rates too quickly short circuiting the US economy and undermining his trade war with the rest of the world. A quick Google search is all anyone needs to witness Trump's frustration. And frustration really is apropos here because Powell was Trump's own nominee for the top gig at the Federal Reserve in the first place. For three years, the Fed has been tightening monetary policy in a gradual way through two methods: raising the Fed Funds Rate and systematically winding down their Balance Sheet. Many investors believe the U.S. economy is impervious to this monetary tightening while others argued that higher real rates attracted capital and caused a counter intuitive pro-economic response. The MAAM Investment Team disagrees. You see the World and America have never been so indebted…ever. Reducing liquidity through tighter monetary policy of the global reserve currency will have a huge economic impact and resultant market reaction. So, the fear as Trump may see it is that the Fed may cause both a global economic slowdown and a corrective process in many of the world's key financial assets. So, when Powell, in a speech to the New York Economic Club, uttered this phrase, the worlds markets rose about 2.5% in a matter of minutes:

*"Interest rates are still low by historical standards, and they remain just below the broad range of estimates of the level that would be neutral for the economy — that is, neither speeding up nor slowing down growth".*

- Jerome Powell, US Federal Reserve Chair

"Just below" is a long way from "Neutral".

And we think Powell knows this: moving too quickly would risk slamming the brakes on the expansion, while getting behind the curve risks a dangerous rise in inflation which could destabilize financial markets.




**US 2-year yields (blue) dove shortly after Powell spoke while the ESA Index (red) which tracks S&P500 futures took off like a scaled cat.**

Powell's remarks were universally interpreted as Dovish prompting some to christen the start of the "Santa Claus" rally and us to superimpose a beard and Santa hat on Mr. Powell's picture. In addition, Powell's assessment of the economy also sounds more balanced which is in striking contrast to earlier characterizations that bordered on euphoric. The MAAM Investment Team subscribes to the notion that one mustn't "Fight the Fed". But we do think investors should listen to the Fed a bit more clearly. Scott Brown, Ph.D., an Economist with Raymond James had this to say:

*"Note that the key phrase here is 'Interest rates are still low by historical standards, and they remain just below the broad range of estimates of the level that would be neutral for the economy.' The financial press is reporting that 'Powell said that the federal funds rate is just below neutral' - that's not what he said.*

- Scott Brown, Ph.D., Raymond James

To conclude, the MAAM Investment Team certainly agrees that the pace of rate hikes south of the boarder may ease. We also believe that the US Fed Chair is walking a fine line between balancing economic growth and inflation expectations. But we encourage investors to be vigilant at times like these because ultimately, interpreting Powell's speech in New York last week as unilaterally dovish may cause results to vary in portfolios.

**Caffeine and compartmentalizing financial paranoia…**

I love coffee. At 42 years of age you must go quite far back in time to my first experience with java and its central nervous system stimulant caffeine. The year was 1989 and after having watched adults enjoy coffee in front of me for years, I made the decision to try some myself. One sip, and I was hooked, and paranoid. A sobering reality about a life fueled by caffeine is that it can make the user a smidgen paranoid. Most people probably don't know this, but caffeine is the most widely consumed psychoactive drug in the world. Yes, you read that correctly, your trusted and dedicated Portfolio Manager is a drug addict. Now as a Portfolio Manager I suppose I am better equipped to compartmentalize paranoia of the financial variety. But at the end of

the day I am only human and sometimes either financial markets or that 4th cup of "Joe" cause me to worry. Recently everywhere I look I see "red flags" and unlike earlier in the year, the most recent nose dive in financial markets cannot be swept under the rug by offering elegant and attractive sounding explanation to the world's problems and why clients should ignore them. Flare up's in places like Turkey or Argentina, the idea that emerging markets in general aren't durable enough to withstand tighter monetary policy, the Brexit boondoggle or the idea that someone as crazed as Donald Trump could realistically cause a full-blown trade can conceivably worry even that calmest of investors who do not drink coffee.


**The most crowded trade on the planet is starting to get a bit less crowded as Hedge Fund elites in New York, Greenwich and London head for the exits.**

**Exhibit 24: Very Important Positions (VIP) for hedge funds**

New stocks in basket listed in bold; holdings as of June 30, 2018; pricing as of August 14, 2018

**50 stocks that most frequently appear among the largest 10 holdings of hedge funds**

| Company | Ticker | Sub-sector | Equity cap ($ bn) | No. of funds with 10 to 200 positions owning stock 30-Jun-18 | No. of funds with stock as top 10 holding 30-Jun-18 | Average portfolio weight when stock ranks among top 10 holdings | % of equity cap owned by hedge funds 30-Jun-18 | Total return YTD |
|---|---|---|---|---|---|---|---|---|
| Facebook Inc. | FB | Internet Software & Services | $434 | 145 | 98 | 8 % | 5 % | 3 % |
| Amazon.com Inc. | AMZN | Internet & Direct Marketing Retail | 931 | 114 | 81 | 8 | 2 | 64 |
| Microsoft Corp. | MSFT | Systems Software | 842 | 114 | 76 | 7 | 2 | 29 |
| Alphabet Inc. | GOOGL | Internet Software & Services | 753 | 89 | 54 | 6 | 3 | 19 |
| NXP Semiconductors | NXPI | Semiconductors | 31 | 60 | 47 | 8 | 41 | (22) |
| Alibaba Group Hldg (ADR) | BABA | Internet Software & Services | 435 | 79 | 43 | 8 | 2 | 0 |
| Visa Inc. | V | Data Processing & Outsourced Services | 251 | 67 | 43 | 6 | 3 | 24 |
| Aetna Inc. | AET | Managed Health Care | 64 | 50 | 41 | 8 | 16 | 10 |
| PayPal Holdings | PYPL | Data Processing & Outsourced Services | 104 | 47 | 31 | 7 | 5 | 19 |
| Comcast Corp. | CMCSA | Cable & Satellite | 163 | 43 | 30 | 7 | 3 | (10) |
| **Twenty-First Century Fox** | **FOXA** | **Movies & Entertainment** | **68** | **45** | **28** | **7** | **16** | **32** |
| Bank of America | BAC | Diversified Banks | 312 | 56 | 27 | 6 | 1 | 5 |
| Apple Inc. | AAPL | Technology Hardware Storage & Peripherals | 1,031 | 49 | 25 | 7 | 1 | 25 |
| Citigroup Inc. | C | Diversified Banks | 179 | 53 | 24 | 6 | 3 | (4) |
| Caesars Entertainment Corporation | CZR | Casinos & Gaming | 6 | 39 | 24 | 6 | 45 | (24) |
| Wells Fargo & Co. | WFC | Diversified Banks | 283 | 35 | 24 | 6 | 1 | (2) |
| Dell Technologies Inc Class V | DVMT | Systems Software | 19 | 36 | 22 | 7 | 27 | 17 |
| **T-Mobile US Inc.** | **TMUS** | **Wireless Telecommunication Services** | **56** | **35** | **22** | **7** | **7** | **4** |
| **Rockwell Collins** | **COL** | **Aerospace & Defense** | **22** | **24** | **22** | **8** | **16** | **0** |
| Berkshire Hathaway | BRK.B | Multi-Sector Holdings | 508 | 27 | 21 | 9 | 1 | 4 |
| salesforce.com, inc. | CRM | Application Software | 109 | 39 | 21 | 6 | 4 | 43 |
| **XL Group Ltd.** | **XL** | **Property & Casualty Insurance** | **15** | **29** | **21** | **5** | **19** | **62** |
| Allergan plc | AGN | Pharmaceuticals | 63 | 35 | 20 | 8 | 7 | 14 |
| JPMorgan Chase | JPM | Diversified Banks | 390 | 36 | 20 | 5 | 1 | 9 |
| DowDuPont Inc. | DWDP | Diversified Chemicals | 157 | 37 | 19 | 4 | 4 | (4) |
| Mastercard Inc. | MA | Data Processing & Outsourced Services | 210 | 49 | 19 | 6 | 2 | 35 |
| TransDigm Group | TDG | Aerospace & Defense | 19 | 27 | 19 | 9 | 24 | 30 |
| Charter Communications | CHTR | Cable & Satellite | 73 | 37 | 18 | 9 | 6 | (8) |
| Adobe Systems Inc. | ADBE | Application Software | 126 | 32 | 17 | 6 | 5 | 46 |
| Netflix Inc. | NFLX | Internet & Direct Marketing Retail | 147 | 31 | 17 | 9 | 5 | 76 |

**Hedge Funds are under siege…the above table from Goldman Sachs shows why.**

Don't get me wrong…things that matter still matter…

1. The rotation of growth to value which for a time seemed like it was never ever going to happen seems to be materializing: those of you dependent on momentum driven ETFs that feast on "FAANG*" stocks were warned
2. Big cap technology names experienced their worst October since 2008
3. BBB rated credits and fallen angel risk-soaked fears of just what exactly is "investment grade" credit anymore
4. Crude Oil prices (at the time *The Monthly* hits your inbox) were slammed…and that's only if you weren't in Alberta…where Western Canada Select oil was downright flattened
5. The once touted story about synchronized global growth has morphed into a tail of synchronized global slowdown
6. Demand concerns on Apple and quarterly results from Nvidia teach us that semi-conductors require our *full* attention

Imaginations can run wild when everything starts to fall apart at the same time. But don't cancel that double espresso shot just yet. Somewhere out there something *is* imploding, you can bank on that. But one key input we have talked about at length in these missives isn't: interest rate volatility is decoupling from other barometers of fear. So, what has changed? Well the reality is that rising rates aren't causing the current malaise in markets if anything that damage has already been

done (we note on the first page of *The Monthly* **another** month of troubling auto sales…we also wonder how Canadians with variable rate loans are managing). Rather than the rates themselves we believe it may be the perception that *future* rate hikes are no longer "money in the bank" is what is causing a real problem. Central Bankers are either behind the curve or not, but the rapid juxtaposition of hawkish and dovish views is what we feel the markets are having a tough time getting their heads around. We might give decaf a try one day but until then we will let our time-tested investment process guide our investment decisions and ease our worried minds.

If you or someone you know feels the market is persecuting them or have jealous feeling towards some of the investments your neighbor (claims) to own…give us a call. Above all else we are here for you.

**Firm News**

MAAM Research Analysts will be attending Hedge Fund manager meetings in New York this week to gain insight into their views.

MAAM Portfolio Managers were in Miami, FLA earlier to conduct onsite inspections of properties and speak with partners in the United States to ensure growth is still robust.

As this will be our final edition of *The Monthly* before we enter the year 2019, we would like to thank all of you for your support again this year. Here's hoping everyone has a Merry Christmas, Happy Hanukkah and a Happy New Year! We also take this opportunity to thank our readers for their interest in our views. We hope you enjoy reading *The Monthly* as much as we enjoy writing it.


**MacNicol & Associates Asset Management Inc.**

* FAANG is an acronym for the market's five most popular and best-performing tech stocks, namely Facebook, Apple, Amazon, Netflix and Alphabet's Google.