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

January 2019

The Quarterly

With this commentary, we plan to communicate with you quarterly 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.

"For every minute spent in organizing, an hour is earned."

- Benjamin Franklin, One of the Founding Fathers of America

The Numbers:

Index:		**Year-to-Date:**
S&P/TSX:		4.38%
NASDAQ:		4.85%
Dow Jones:		2.36%
S&P 500:		3.12%
Interest Rates:	**Canada**	**US**
90-Day T-Bill:	1.62%	2.42%
5-Year Bond:	1.90%	2.53%
10-Year Bond:	2.02%	2.70%
30-Year Bond:	2.16%	3.04%

Economic Data:

- Bank of Canada holds overnight rate at 1.75%
- December 2018 is officially the 11th worst performing month in history for the S&P500
- Canadian dollar fluctuates more in December 2018 trading in a ($0.73-$0.75USD) range
- Crude flat (for December) however futures briefly dipped below $43 on Christmas Eve
- December US non-farm payrolls of 312,000 smashes expectations of only 177,000

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	19.1	25.0
P/B: Price-to-Book	3.1	3.3
P/S: Price-to-Sales	2.0	2.2
Yield: Dividend Yield	2.1%	1.8%

Year-to-date Performance, by Sector: January 10th, 2019

U.S. Markets	Close	Net	1 Day % Chg	YTD %
Dow Jones	23879.12	91.67	0.39%	2.36
Dow Jones Transports	4757.32	63.03	1.34%	3.30
Dow Jones Utilities	707.29	-4.14	-0.58%	-0.79
S&P 500	2584.96	10.55	0.41%	3.12
NASDAQ	6957.08	60.08	0.87%	4.85
Russell 2000 (Smallcaps)	1438.81	12.25	0.86%	6.69
BKX (Banking)	90.42	0.76	0.85%	5.40
BTK (Biotech)	4688.87	45.01	0.97%	11.09
XOI (Oil Index)	1254.82	22.78	1.85%	8.26
SOXX (Semiconductor)	1189.84	29.30	2.52%	3.00

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 previous months 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 January 11,2019 11:30 AM	$ 5,000	Cdn		
Banks	Rate	**Buy USD**	**Cost**	**% Difference from Spot Rate**
CIBC	No Public Rate Posted Online			???
Interactive Brokers	1.3263	$ 3,770	$ (28)	-0.8%
Laurentian Bank	No Public Rate Posted Online		$ (3,798)	???
National Bank	1.3164	$ 3,798	$ -	0.0%
Raymond James	1.3370	$ 3,740	$ (59)	-1.6%
Royal Bank	1.3530	$ 3,695	$ (103)	-2.8%
Scotia	1.3623	$ 3,670	$ (128)	-3.5%
TD	1.3599	$ 3,677	$ (121)	-3.3%
Spot Rate	1.3164			

Good Riddance…

Investors will probably choose to forget 2018, and that's understandable. 2018 was a money losing year for investors and stocks underperformed on a relative and absolute basis. The S&P500 fell by over 4% and Canadian equities did even worse than that. If you were a Canadian small cap investor 2018 was extremely uncomfortable and for US investors holding Canadian stocks things got downright painful. But 2018 started off strong and expectations were high: we recall multiple forecasts for a 3,000 S&P500 index. Markets were strong in 2017 and very smooth, it was the best of both worlds for investors who prefer to simply assume everything is okay and stuff will just sort itself out.

Back at our offices in downtown Toronto, the only real volatility we observed in 2017 was getting use to Donald Trump as US President and his "TWIT-taitorship". So, as you will appreciate, 2018 proved to be a wake-up call to investors. Investors got their first taste of trouble during the "February flop". Stocks fell about 10% on rising interest rate worries which confused a lot of investors: the economy was supposedly strong and functioning at nearly full capacity? Surely a couple of very small rate hikes were nothing to worry about? Another "blip" occurred in June on concerns over a slowdown in China, a correction in North American real estate and BREXIT. By mid-October Bear attacks were being reported.

Encounters with bears were not limited to neighborhoods in the greater Toronto area and there were few places to hide in late 2018. Driven by concerns over a slowing Chinese economy, Asian equities performed poorly with the broader Emerging Market space offering little respite from the damage. European stocks were also down so investments in the eurozone didn't help either.

Was your portfolio mauled by a "Bear Attack" in 2018? If it was just log on to our website www.MacNicolAsset.com and see if our own unique brand of Bear "repellent" can help you or someone you know.

MARKET	MTH-END 2018-12-31	MTH-END 2018-11-30	QTR-END 2018-09-28	YEAR-END 2017	CHG THIS MONTH	CHG THIS QUARTER	CHG IN 2018
EQUITY MARKET							
CANADA							
S&P/TSX COMPOSITE	14323	15198	16073	16209	-5.8%	-10.9%	-11.6%
S&P/TSX TOTAL RETURN INDEX	49204	52015	54739	54003	-5.4%	-10.1%	-8.9%
S&P/TSX 60	859	913	952	960	-5.9%	-9.8%	-10.5%
S&P/TSX COMPLETION	855	903	998	1009	-5.3%	-14.3%	-15.2%
S&P/TSX SMALLCAP	528	549	621	661	-3.9%	-15.0%	-20.1%
S&P/TSX VENTURE	557	590	709	851	-5.5%	-21.4%	-34.5%
UNITED STATES							
S&P 500	2507	2760	2914	2674	-9.2%	-14.0%	-6.2%
S&P 500 TOTAL RETURN INDEX	4984	5479	5763	5213	-9.0%	-13.5%	-4.4%
S&P 1500	577	637	674	619	-9.4%	-14.4%	-6.8%
DOW JONES INDUSTRIALS	23327	25538	26458	24719	-8.7%	-11.8%	-5.6%
NASDAQ	6635	7331	8046	6903	-9.5%	-17.5%	-3.9%
RUSSEL 2000	1349	1533	1697	1536	-12.0%	-20.5%	-12.2%
INTERNATIONAL							
FTSE 100 (UNITED KINGDOM)	6728	6980	7510	7688	-3.6%	-10.4%	-12.5%
CAC 40 (FRANCE)	4731	5004	5493	5313	-5.5%	-13.9%	-11.0%
DAX 30 (GERMANY)	10559	11257	12247	12918	-6.2%	-13.8%	-18.3%
NIKKEI 225 (JAPAN)	20015	22351	24120	22765	-10.5%	-17.0%	-12.1%
SHANGHAI SE A SHARE (CHINA)	2611	2710	2955	3463	-3.6%	-11.6%	-24.6%
MSCI EMERGING MARKETS	53420	54947	57943	60879	-2.8%	-7.8%	-12.3%
MSCI EAFE	1720	1810	1974	2051	-5.0%	-12.9%	-16.1%
MSCI WORLD	1441	1566	1666	1586	-8.0%	-13.5%	-9.1%

Canadian, USA and International markets all struggled for traction in 2018 but mostly failed, Source: Canaccord Genuity.

So, what caused markets to abruptly reverse course in October 2018 despite accepting risk earlier in the year? The MAAM investment team surmises that a watershed moment may have occurred. Without warning global growth projections from: investment banks, government agencies and policy setting bodies underwent a series of downward revisions. Think tanks around the world felt economic growth was waning and falling out of sync, and this was a real "Black Swan" to investors. The previous belief in synchronized global growth had given way to the view that not only was the global growth story no longer synchronized but no longer a growth story.

The "Black Swan" that has investors very worried is that economic growth might not be as strong, or synchronized, as we once thought.

With global growth in question, we are left questioning Emerging Markets. We hold emerging markets in our MacNicol Absolute Return fund and feel confident about the Partnerships we have made in the fund, but we are not adding to our positions at the present time. Recall that US rate hikes continue for the time being and this is not a particularly good thing for Emerging Markets.

<u>What's an investor to do?</u>

Waking up to a new economic normal in which economic growth may not meet prior expectations is challenging for investors to accept. It conflicts with prior views of a vibrant economy, and questions whether further rate hikes are really necessary. Corporate earnings, which look "peakish" to us, will have to be discounted at higher-rates and this is bad for stocks. A new (weaker) economic normal also undermines the credibility of unconventional monetary policy (uber low rates + central bank asset purchases). Quite frankly, few things trouble us more than having to accept the idea policy makers might be at some kind of dangerous precipice in which they are out of "ammunition" in the fight to sustain the convergence of economic growth to a very small 2%. Few things that is except the idea that the economy was never really that strong to begin with.

The Philadelphia Eagles are not my top pick to win the Super Bowl this year, but they are my 2nd choice.

How can everything simultaneously be "so good" yet so fragile? An economic implosion is not our base case scenario. But we are concerned that economic growth may be slowing and decoupling.

They say defense wins championships, *we say* defense can also mean the difference between getting to your financial goals or not. The MAAM investment team ultimately believes that we are now at the very late innings of the economic and capital markets' cycle and have refined in three specific ways: new client capital is deployed more selectively, our capitalization approach is biased toward larger cap names versus growthier names and finally our sector allocation strategy is targeting safer havens like Utilities, Healthcare, Real Estate and Consumer Staples. We believe this is a prudent strategy for investors to follow in what is likely to be a transitional period in global markets.

If you know someone who is anxious about their investments, please have them call us. To paraphrase Benjamin Graham at the start of *The Quarterly* a brief phone call could lead to smoother sailing down the road.

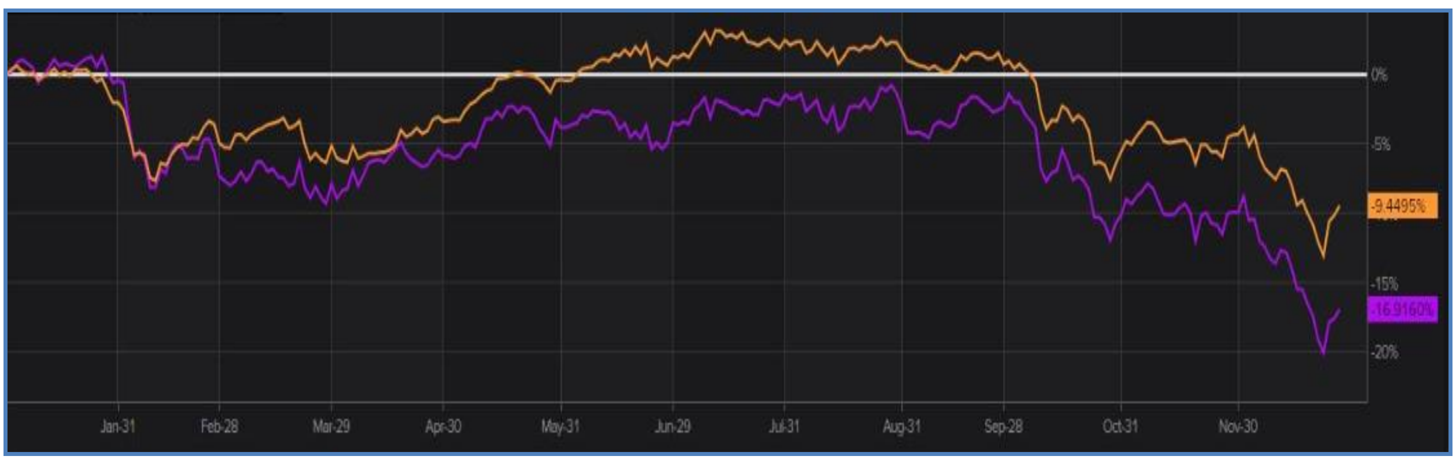
The MAAM Investment Team

Value...*eh*...

As demonstrated in "Good Riddance", Canadian equities were a lousy place to be...and they were an especially lousy place to be if you were an American investor. The MAAM investment team is talking about Canadian equities a lot more these days. Last week's research meeting covered several sectors in Canada and we will likely do a "Deep Dive" soon.

We own Canadian Equities in the majority of client portfolios and names like Barrick Gold, Canadian Pacific Railway and Royal Bank of Canada are popular holdings. But would we add to our positions right now?

"Yes" we would…given certain catalysts…



Canadian Equities didn't do too well in 2018 but don't tell your friends in Florida or Arizona…they already know that.
Source: Thompson Reuters.

What are the catalysts?

One is any sort of moderation in the yield curve or at the very least some sideways movement. This would undoubtably function to remove the belief in the threat of yield curve inversion as a clear and present danger, and support banking shares. In the energy patch, which continued to lose jobs and cut production, greater Government intervention is needed to help export more of our capacity to global markets. Pipeline projects are ways to strengthen our economy and should be one of Canada's highest possible national priorities. Finally, a rise in the Yen, which has been extremely informative in explaining the price of Gold would elevate the value of Canadian gold miners, which collectively represent about 7% of the S&P/TSX.

Are the above catalysts likely?

It is extremely hard to say something is “likely” or “unlikely”, particularly a prediction. Consider for a moment that the Office of the Superintendent of Bankruptcy recently indicated that insolvency is at a 7-year high, and not just in Alberta. But that 7 year high comes off a very low level. Still we are sad to hear anytime a Canadian has lost their job or business.

However, because insolvencies are not making new highs and instead simply higher than any point in the last 7 years, we do not see them "tipping" the economy into a recession. Yield curve inversion is therefore not our base case scenario. NAFTA problems have been replaced by renewed concerns over BREXIT putting Canada's economy into a situation of "if it isn't one thing it's another". The MAAM investment team feels that more of the Canadian economy hinges on its relationship with the US economy. The United Kingdom is Canada’s largest European trading partner, but it is still significantly smaller than what we transact with Americans.

We said proximity not wishing you had a Nexus Pass.

The synchronicity of the global economic expansion has fallen off the tracks, Canada's proximity and trade relationship with the United States should help pull us through periods in which global economic or geopolitical risks rise.

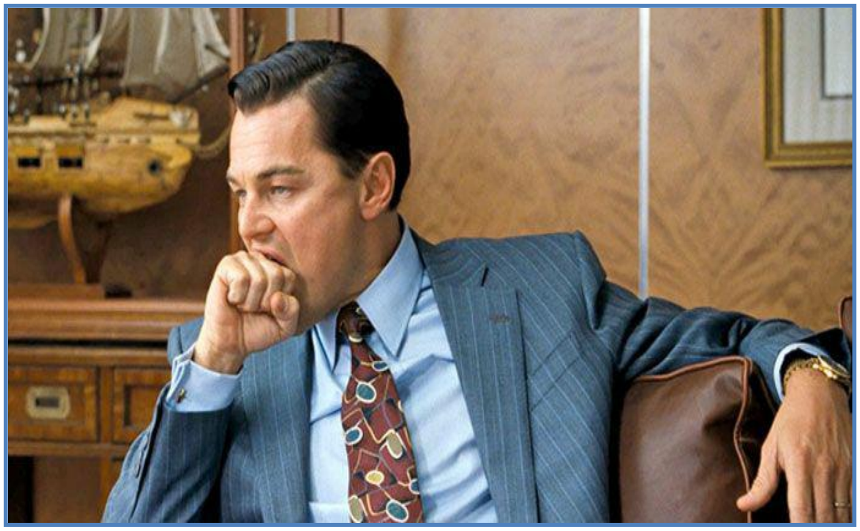
Speaking of Canada’s proximity to the United States is it time for a wider range of fiscal policy measure from our Government? The Canadian economy has been operating at capacity for a solid year and that has had the impact of making budget deficits relatively small as a share of the overall economy. Moreover, Federal debt as a share of the economy has declined from 92.4% in 2016 to 89.6% in 2017 and into the 60% range currently (Source: Department of Finance, Canada) so the need for meticulously orchestrated fiscal policy is not here yet despite our own personal preference for greater professionalism in the management of our nation’s export pipeline capacity. A degree of fiscal policy importance will undoubtably rise as monetary policy measures are further removed from underneath the economy yet the oil patch remains a different story all together. The Energy patch remains badly bruised. If more of our export capacity could reach global markets, Canadian Oil & Gas company revenues would be higher and the sector would employ more Canadians. Prime Minister Tredeau supports pipeline projects like Shell’s LNG Canada export terminal and the associated Coastal GasLink pipeline. However, native groups are accusing the Canadian Government of doing their best to avoid acknowledging other systems of government. It is way too early to suggest that Shell and TransCanada are facing the same obstacles that killed Northern Gateway, Energy East and severely wounded the Trans Mountain

Expansion. But Shell's LNG project, which is one of the largest investments in new LNG export capacity in the world in recent years, may not experience the smooth ride that company executives had expected.

With respect to Gold, we believe that prices are set to rise on a strong correlation with the Japanese Yen. Both currencies have moved in sync recently and stores of value really aren't the reason why. Rather, both respond well to negative Real Yields. If the American economy is as hot as some suggest then perhaps the Federal Reserve is behind the ball when it comes to inflation and this could prop up Gold and the Yen.

Canadian equities represent an attractive value proposition, but are our stocks inexpensive for a reason? Time will tell, for now, know that the MAAM investment team certainly has our nation's stock markets under watch for good deals and growth catalysts.

<u>Contrarian or Lemming?</u>

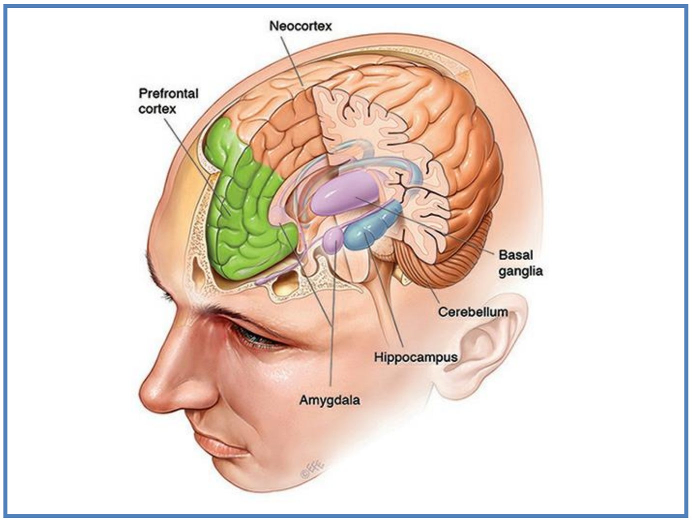


Pin stripes and fancy watches betray an underlying concern framed by what is usually nothing more than a thin veneer of confidence.

Warren Buffett once noted "A pack of lemmings looks like a group of rugged individualists compared with Wall Street when it gets a concept it its teeth". One author we follow (and love) James Montier quips that this is defamatory to rodents. The MAAM investment team is left to ponder whether prospective investors would stick to their own guns or allow themselves to be subjugated by a raucous majority? In a "do it for me" and "do it with me" world of online this and Robo that Portfolio Managers like ourselves have veto power over those who have hired us and agreed to sign an investment management agreement. And so, an important input into arriving at the dichotomy between a rodent and Rockstar banker is the ability to cede power to someone who may not necessarily have flawless clairvoyance, but rather who has a time-tested process that actually works along with your best interests in mind. The reality of the world we live in is that going against the crowd, for many, is painful. Doing something different with your investments, such as considering Alternative Assets, is the equivalent of seeking out social pain. In effect, non-conformity triggers fear.

Why?

For answers we turned to a piece by Professors: Gregory. S. Burns, Jonathan Chappelow, Caroline Zink, Giuseppe Pagoni, Megan E. Martin-Skurski of Emory University along with Dr. Jim Richards of the Georgia Institute of Technology. In "Neurobiological Correlates of Social Conformity and Independence During mental Rotation", the brain wizards used MRI machines to investigate the neural basis of individualistic and conforming behavior. Conformity was associated with functional changes in an occipital-parietal network, especially when the wrong information originated from other people. Independence was associated with increased amygdala and caudate activity, findings consistent with the assumptions of social norm theory about the behavioral saliency of standing alone. The fundamental underpinnings of conformity and independence thus are rooted in neuroscience.



The Occipital and Parietal Network are not shown in this diagram but they can be found in the prefrontal cortex region…trust us.

Feeling a little "pre-frontal" when it comes to your investments?

Just give us a call 1**-866-367-3040** or visit www.macnicolasset.com

Firm News

MAAM Portfolio Managers will be in New York in early February attending a conference focused on trading as well as meeting with private equity partners.

Strategic Analysis Corporation, our sister company, welcomes Gilbert Enenajor to their team. With a background in Law, Gilbert will apply his passion for investing to his new role as a Research Analyst.

And big (and we mean really big) congratulations to our own Naima Egal and her husband Latif who are expecting a new addition of their own…and this time it's a girl! Congratulations Naima and Latif!

MacNicol & Associates Asset Management Inc.