MACNICOL
& ASSOCIATES
ASSET MANAGEMENT INC.

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February 2019

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 mutual fund industry has been built, in a sense, on witchcraft."

- John C. Bogle in *Common Sense on Mutual Funds: New Imperatives for the Intelligent Investor*

The Numbers:

Index:		**Year-to-Date:**	
S&P/TSX:		8.25%	
NASDAQ:		6.79%	
Dow Jones:		5.15%	
S&P500:		5.47%	
Interest Rates:	**Canada**		**USA**
90-Day T-Bill:	1.50%		2.40%
5-Year Bond:	2.16%		2.51%
10-Year Bond:	2.23%		2.68%
30-Year Bond:	2.24%		3.02%

Economic Data:

- January a "rebound" month for developed equities
- Bank of Canada's Wilkins suggests wage inflation will pick up on worker shortages facing employers
- Volatility normalizes down to 5-year trend
- Gold easily pierces $1,300 on strikingly dovish US Fed meeting while US yield curve clearly pivots towards inversion on a clockwise rotation
- Crude oil stronger in January on a lower-than-expected inventory build
- European and mainland Chinese markets stronger in January with South Pacific Bourses showing less follow through

Valuation Measures: S&P 500 Index

Valuation Measure	Latest	1-year ago
P/E: Price-to-Earnings	20.73	23.82
P/B: Price-to-Book	3.23	3.20
P/S: Price-to-Sales	2.09	1.98
Yield: Dividend Yield	1.99%	2.09%

Year-to-date Performance, by Sector: January 28th, 2019

U.S. Markets	Close	Net	1 Day % Chg	YTD %
Dow Jones	24528.22	-208.98	-0.84%	5.15
Dow Jones Utilities	704.51	-3.69	-0.52%	-1.18
S&P 500	2643.85	-20.91	-0.78%	5.47
NASDAQ	7085.68	-79.18	-1.11%	6.79
Russell 2000 (Smallcaps)	1473.54	-9.32	-0.63%	9.27
BKX (Banking)	98.10	-0.10	-0.10%	14.36
BTK (Biotech)	4773.54	-97.46	-2.00%	13.09
XOI (Oil Index)	1244.01	-14.50	-1.15%	7.33
SOXX (Semiconductor)	1254.40	-26.76	-2.09%	8.59

Source: Jeff 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. 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 February 1, 2019 1:20 PM	$ 5,000	Cdn		
Banks	**Rate**	**Buy USD**	**Cost**	**% Difference from Spot Rate**
CIBC	No Public Rate Posted Online			???
Interactive Brokers	1.3077	$ 3,824	$ -	0.0%
Laurentian Bank	No Public Rate Posted Online			???
National Bank	1.3180	$ 3,794	$ (30)	-0.8%
Raymond James	1.3240	$ 3,776	$ (47)	-1.2%
Royal Bank	1.3361	$ 3,742	$ (81)	-2.2%
Scotia	1.3457	$ 3,716	$ (108)	-2.9%
TD	1.3404	$ 3,730	$ (93)	-2.5%
Spot Rate	1.3077			

The Death of Indexing?

Blair Academy didn't exactly give out diplomas…you had to earn one.

Thankfully the word "giant" is not used liberally in the investment world and that's a very good thing. These days it seems that everyone in our industry is either a Vice President or a Director, so it can be difficult for investors to know who to listen to. Yet "giant" is entirely appropriate for describing the late John Bogle (who went by "Jack"). Jack Bogle was a giant in the investment world and his name belongs right up there with other industry luminaries like Warren Buffet and George Soros. But Bogle's gigantic status in the investment world came from a small and challenging beginning.
Bogle was born in 1929 and he experienced 1st hand the pain that the great depression inflicted upon the state of New Jersey and other places. Bogle's family lost much of their money back then and led to his father's struggle with addiction and his parents' eventual divorce. Perhaps those early (and painful) years taught Bogle the value of hard work. As a boy, Bogle was an ace student, especially when it came to mathematics. Bogle's early success in academics allowed him to transfer from his original New Jersey high school to Blair Academy, a highly respected preparatory institution for today's young leaders of tomorrow.

Bogle graduated from Blair with distinction and set off for Princeton University, which was only about 90 minutes away. Bogle's hard work and talent paid dividends at Princeton too. His senior thesis was entitled *The Economic Role of the Investment Company* was not only a wickedly intelligent and biting exposé of the then contemporary American mutual fund industry but a window to the future. It was an instant hit with his Professors and classmates. The Princeton years

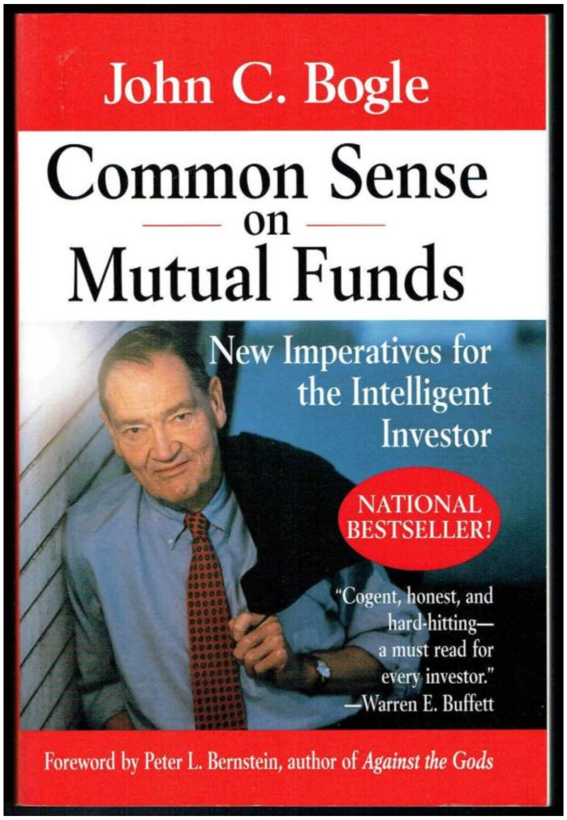
thus offered a glimpse into the future of one the worlds top money managers, but they also offered a glimpse of the seminal "disruptive technology" in finance.

After Princeton, Bogle set off to work at the Wellington Fund where he quickly impressed his colleagues and Wellington Founder Walter Morgan. Morgan, for his part, holds the distinction of being the manager of America's first balanced fund, an achievement in its own right. Not surprisingly, Bogle's accomplishments at Wellington were like those in other aspects of his career: elegant and substantial. It wasn't always perfect though. In his later years at Wellington during which he led the firm Bogle approved an unfortunate merger that ultimately cost him his job. These things happen. Yet, Bogle was quoted as saying the following in the years after the ill-conceived merger:

"The great thing about that mistake, which was shameful and inexcusable and a reflection of immaturity and confidence beyond what the facts justified, was that I learned a lot".

- **John Bogle**

Princeton's motto means "Under God's Power She Flourishes". Bogle's name would have joined and been joined by numerous alumnae that have flourished in a wide variety of fields. Famed Mathematicians John Nash and Alan Turing, Michelle Obama, Amazon CEO Jeff Bezos, Acting US Federal Reserve Chair Jerome Powell, famed author F. Scott Fitzgerald and President John Kennedy all earned Princeton degrees.



There aren't a ton of "must read" books on investing, this is one of them though.

Does your investment professional ever talk about the bets that did not pay off?

Bogle went on to found the Vanguard Group and pen the investment classic *Common Sense on Mutual Funds: New Imperatives for the Intelligent Investor.*

Bogle, of course was an indexer and he was a darn successful one at that. As of January 2018, the Vanguard Group's assets stood at $5 Trillion approximately the size of 6 Canada Pension Plans rolled into one.

Vanguard®

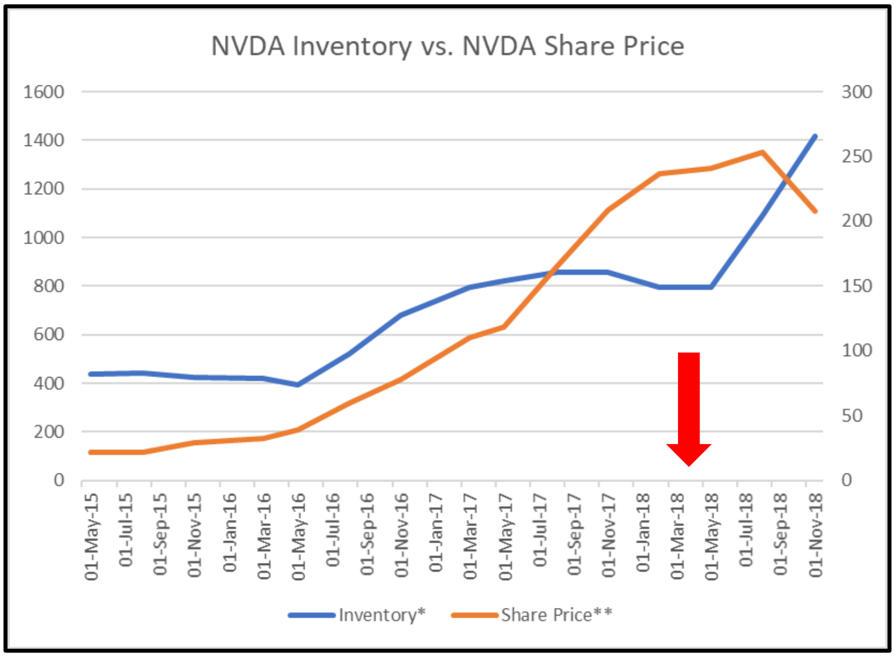
"Giant" is apropos when it comes to Bogle and truly apropos when it comes to the Vanguard Group. $5 Trillion is the amount of share buybacks conducted by all S&P500 companies since the global financial crisis started a decade ago.

Mercifully the world said good-bye to Bogle on January 16th, 2019. He was a few months shy of his 90th birthday but in poor health and having suffered numerous health challenges along the way. Family and friends will undoubtably miss him, but investors will never forget his contributions to the investment world. When the MAAM Investment Team looks back on Bogle and his career we naturally do so with great reverence. At the same time Bogle was an interesting paradox to us. On the one hand you had a founder known for his hard-working, "roll-up-the-sleeves" attitude yet on the other hand you have an investment philosophy built around the arguably easier approach to investing: indexing. In previous editions of *The Monthly*, we have cautioned and even criticized index investing as an investment strategy. So perhaps some clarification is on order. We are certainly fans of Bogle though we obviously fall short of preaching at his alter. Still, characterizing *all* Index funds as harmful is probably harmful on its own. We encourage investors to think about the application of indexing in their own portfolios though we maintain our view that investors should never blindly pile into these things without first taking a much closer look. Investors shouldn't feel guilty though; indexing is a financial innovation often sold to investors under the false pretense that investing is simple. Investing certainly *can* be simple, but it can also be deceptively simple. Perhaps an example will help to illustrate this. If you had a keen interest in the technology space, then it is entirely reasonable to assume that you might be interested in technology stocks. A stock like Nvidia which makes the processing units ["chips"] that allow computers to function as a cohesive machine might very well be on your radar as a potential investment. But just what sort of "chips" does Nvidia make and where are the used? More on that in a moment. For now, have a look at the table below:

Period	Date	Inventory*	Share Price**	Quarter Revenue*	Bitcoin Price**
2015 Q1	20-May-15	438	21.7	1,151	237.06
2015 Q2	19-Aug-15	441	21.52	1,153	267.02
2015 Q3	18-Nov-15	425	29.39	1,305	348.28
2015 Q4	17-Mar-16	418	32.06	1,401	417.7
2016 Q1	25-May-16	394	39.14	1,305	451.62
2016 Q2	23-Aug-16	521	59.46	1,428	581.2
2016 Q3	22-Nov-16	679	77.99	2,004	718.74
2016 Q4	1-Mar-17	794	110.09	2,173	1089.18
2017 Q1	23-May-17	821	118.06	1,937	1792.22
2017 Q2	23-Aug-17	855	164.88	2,230	3814.09
2017 Q3	21-Nov-17	857	208.29	2,636	7223.72
2017 Q4	28-Feb-18	796	237.16	2,911	9867.23
2018 Q1	22-May-18	797	240.78	3,207	8824.48
2018 Q2	16-Aug-18	1,090	253.03	3,123	6957.77
2018 Q3	15-Nov-18	1,417	207.81	3,181	6370.45
Today	31-Jan-19		140.28		3552.23

*Millions
**20 Day Moving Average Price

This table shows Nvidia's inventory of processors alongside its share price and the price of Bitcoin. Two things are worth noting: first, while Nvidia makes a wide variety of processors but the majority of them find jobs inside computers that are used extensively for video gaming…and?…mining digital cryptocurrencies, secondly computer processors don't exactly age well (as a matter of fact they have an extremely short "shelf life" since newer faster models are always just around the corner.



In this chart we superimpose NVIDIA's share price against an inventory chart. For reference, the large red arrow marks the point in time when BITCOIN began imploding…notice anything? We spare Nvidia the agony of extending the x-axis in the chart much beyond the end of 2018.

Active managers would have presumably begun Nvidia's stock pile of processors that no one wanted. Index investors (may) have attempted to do the same. But remember how we said investing *can be* easy? Well with index vehicles such as the iShares Philadelphia Semiconductor ETF and its ticker symbol "SOXX" connecting the dots so-to-speak was a bit easier to do. However, with other index products, such as the Coincapital "BRAIN" ETF for example, distancing yourself from danger was actually a bit trickier, especially with a name like "BRAIN". It did not help matters that the iShares product held a

6.6% allocation to Nvidia while the “BRAIN” fund held over 8%. So, investing certainly *can be* simple, obviously if Nvidia’s fortunes pivot the Coincapital fund will look very “brainy” indeed, but along the way it (and indexing in general) can also be fraught with risks that saddle investors with the anxiety of a bumpy ride.

Mr. Bogle is gone, but the index approach to investing will surely live on. And we have no problems with that. Afterall more than simply being advocates for an active management we’re really advocates for not just our investors but all investors. So, do your homework, like Mr. Bogle did, or have us do it for you. At MacNicol & Associates we know that meticulously combing through the nuances of every single investment may not be your cup of tea. But it’s been our passion for almost two decades.

The MAAM Investment Team

Snowmagedon: how a massive dumping of snow led to our concerns over a massive dumping of debt...

We are experts in snow removal, at least we are now. Extricating our cars and accessing our front door on January 28th took a lot of shovelling and the resulting lower back pain and stiff muscles took a lot of Rub-8535 to correct. We lost count of the number of Caterpillar “snowploughs” that eventually made their way down our snowy Toronto street. Perhaps seeing the big machines in action is what led us to "dig up" a recent report on the world's largest maker of construction equipment. Unfortunately, unlike digging out our homes digging through “Cat’s” latest 10-Q[1] filing left us feeling concerned.

We don't own a Caterpillar snow plough, which by the way is officially called a Grader, but we are sure glad the City of Toronto does. Our home along with hundreds like it was hit with a tsunami of snow from a passing Alberta "clipper" on January 28th, 2019.

[1] Form 10-Q is a quarterly report mandated by the US Securities and Exchange Commission to be filed by publicly listed corporations.

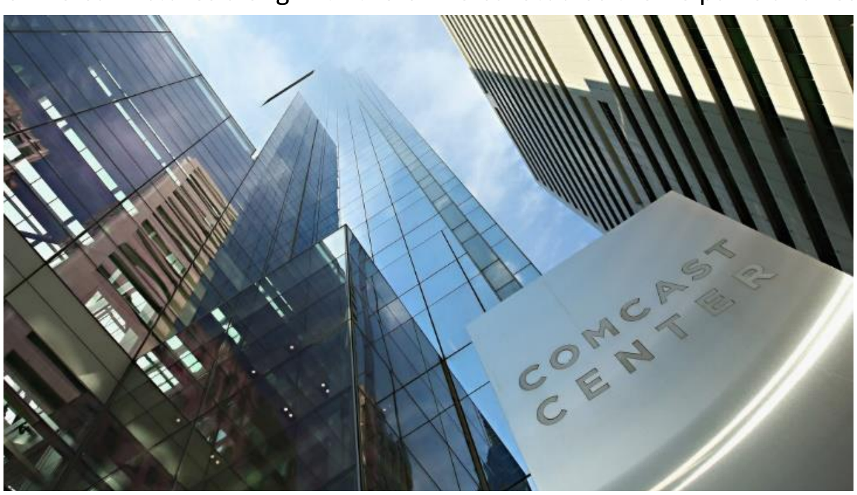
Liabilities		
Current liabilities:		
Short-term borrowings:		
Machinery, Energy & Transportation	$	59
Financial Products		4,462
Accounts payable		6,788
Accrued expenses		3,423
Accrued wages, salaries and employee benefits		2,132
Customer advances		1,491
Dividends payable		—
Other current liabilities		1,867
Long-term debt due within one year:		
Machinery, Energy & Transportation		10
Financial Products		5,801
Total current liabilities		26,033

This is a section of Caterpillar's balance sheet from the company's 10-Q. At $26,033 "Cat's" total debt load seems easily managed by a firm with mining and construction clients all around the world. That's of course until you download the *entire* 10-Q on your computer and discover an annotation advising the reader that the $26,033 figure must be multiplied by 1,000,000 to arrive at the amount of money Caterpillar *actually* owes.

A $26 Billion debt load…for tractors?

Before we look down our noses disapprovingly at Caterpillar, we do wish to thank the company for our clean, eminently usable street following the storm. We also acknowledge that Caterpillar is far from being alone when it comes to piling on the debt. Hundreds of companies have been doing the same, and if you thought the tractor folks had a borrowing problem wait till you see what's going on in the media world.

Comcast is the American telecommunications conglomerate that owns networks like NBC and CNBC. It also owns Universal Pictures along with the Universal Studios theme parks and resorts, as well as, a variety of other "distinct" entities. More recently, Comcast became the new owner of Sky (Europe's largest telecommunications network).



This is the front façade of the Comcast Center in Philadelphia Pennsylvania. Please do not scratch the fancy stainless steel sign…it hasn't been paid for yet.

Hurray, right?

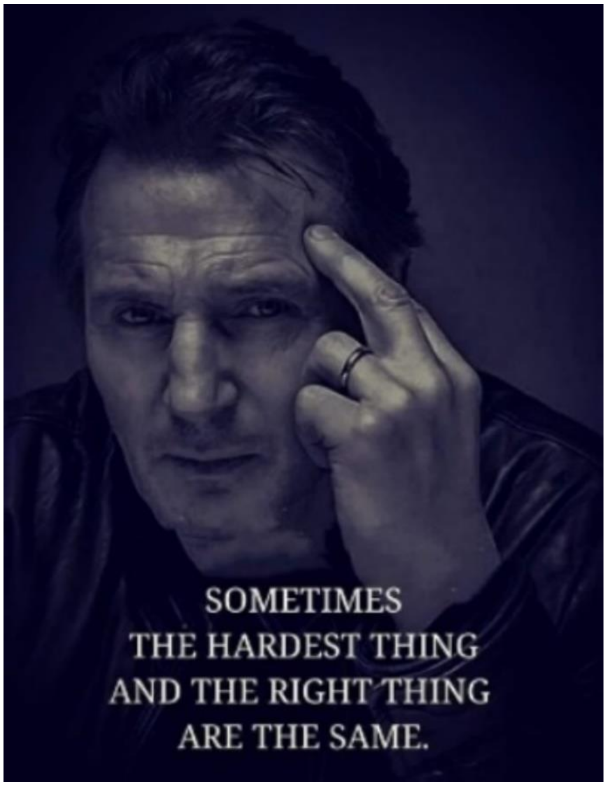
Just hold that thought…

Comcast embarked on an ambitious campaign to pretty much corner the media market, and they have certainly been successful at achieving their goal of having several of the worlds leading media brands under their belt. The trouble is that belt is starting to feel a bit snug. Comcast did not exactly fund its acquisition binge with cash flows. Instead, they did what many large corporations did, they borrowed.

And borrowed and borrowed and borrowed….

Comcast begins 2019 with a truly staggering $115 billion in debt on its balance sheet. This actually makes Caterpillar look (dare we say) financially prudent by comparison and should give you a new perspective on your holiday credit card bills. Comcast hopes shareholders will appreciate that their debt-fueled acquisition binge was necessary to adapt to rapidly changing consumer trends. Unfortunately, the MAAM Investment Team isn't buying it, literally[2]. You see if there is a prolonged economic slowdown, or if interest rates continue to rise, Comcast will probably look back at these transactions as a bad idea. Investors, it would appear, agree with us. Over the past two-years, Comcast shares have not come close to keeping pace with either the tech heavy NASDAQ or the Dow Jones Industrial Average.

Comcast CFO Mike Cavanagh knows the company's leverage ratios better than anyone and he also knows the Analysts who follow the company closely better than anyone. So, when peppered with the debt question during a recent earnings call he confirmed that stock buybacks are out-of-the-question until the company gets its financial house in order. Obviously the MAAM Investment Team is concerned about Comcast but we are also concerned about other companies like Comcast. You read that correctly, as stupefying as it is to believe it turns out the $100 Billion debt club has more than just a lone member. So, who are the other firms skating on thin ice? Well if you guessed more names in the media and telecommunications space you are exactly right: Verizon is bloated to a comparable extent as Comcast while AT&T takes top honors with the $190 Billion its balance sheet is (somehow) able to juggle. Apple and Budweiser Beer's parent AB Inbev round out the list of "spendthrifts". Ford Motor Company would have made the list if we factored in their finance arm…perhaps they'll just have to try harder next year.

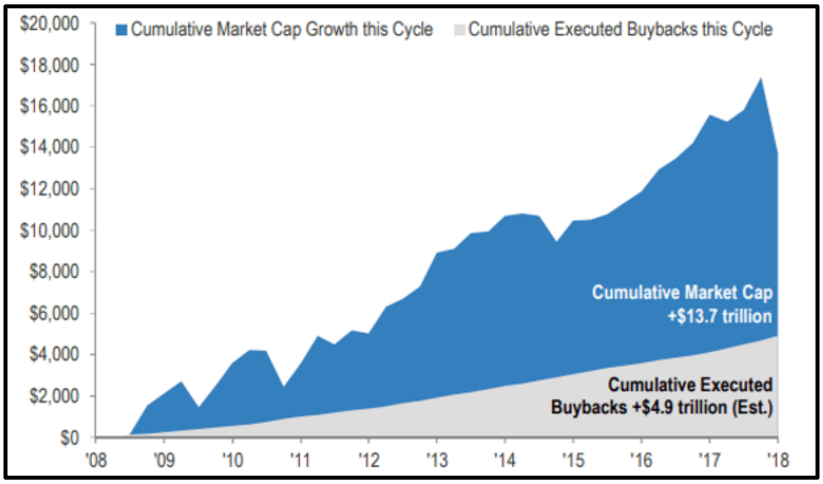


Comcast's debt load does carry with it the potential to be at the vanguard of the next generation of media innovation and this obviously has its rewards. But it also has the potential to plunge the company into the financial abyss if the media space experiences shaky economic times or wildly unpredictable consumer preferences.

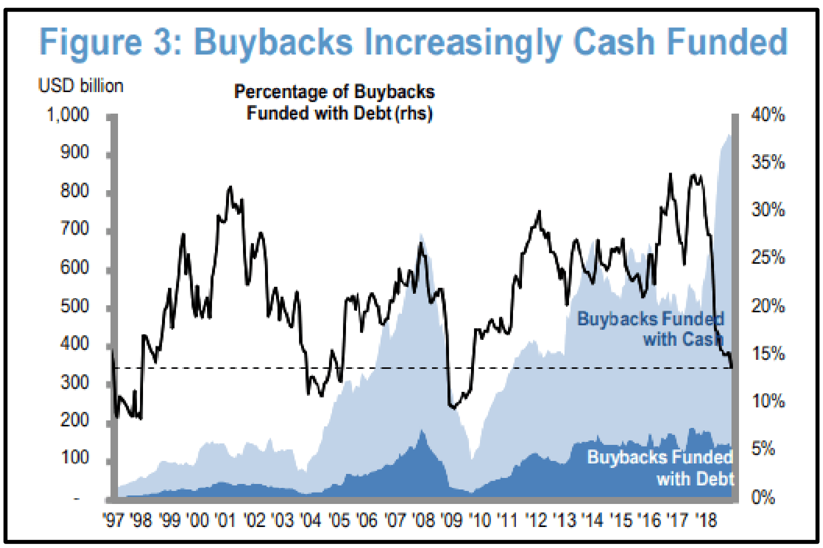
[2] No MacNicol & Associates client portfolio or fund holds Comcast

It is obvious to us that excessive debt is problematic. So, while we are concerned in general, MAAM client portfolios are safeguarded. We will circle back in the future every now and again to see how these companies are doing. After all, we don't particularly have an issue with their underlying assets, we just feel that such heavy debt loads will undermine their ability to prosper should financial conditions darken.

Speaking of share buybacks…



The S&P500 has certainly done a good job of growing on its own…but there is no question share buybacks have helped during the current market cycle.



Buybacks are big and set to continue. Fortunately, it appears as though fewer buybacks are being financed with borrowing.

In an age of uber low rates corporate buybacks of shares are (sometimes) a good way to invest capital.

Since 2009 what has been happening is a bit different. Corporate Chiefs have been borrowing as much money as they can to buyback shares, which does drive earnings per share growth higher but only because there are less shares to go around. The "good" news is that buybacks financed by borrowing seem to have peaked about 18 months ago.

Nevertheless, since 2009 nearly $5 trillion of shares have been bought back by S&P500 companies and the MAAM Investment Team expects that number to eventually hit $6 trillion. As *The Monthly* hits readers' inboxes $700 billion worth of existing share buyback authorizations sit over top of the S&P500. Thanks to Quantitative Easing (QE) - inspired hunt for yield EPS-inflating buybacks are set to remain a fixture on Bay and Wall Street. To be sure sometimes the best value a company sees is its own stock, and we don't take issue with that. We just question whether investors will continue to support diminishing equity capital (i.e. when indebtedness supersedes a company's market value) in a slow or low growth environment. Thankfully the weather is warming, and the snow shall soon melt away but our concerns about the debt clock will be here to stay.

The MAAM Investment Team

Familiarity Bias

"Gosh I just love these new sport pants I bought at Lululemon…I should really look at buying the stock in my portfolio".

Ah the prefrontal cortex, important in teens, essential in asset allocation.

Relax, in our younger days as a junior portfolio manager we suffered bouts of familiarity bias too. Familiarity bias is the behavioral investment tendency that subconsciously forces investors to invest in things that are familiar to them, like the company they work for or shop at. The biological underpinnings of familiarity bias are pretty straightforward: like billions of humans you likely have a pre-frontal cortex just like us. But the impact on your savings has implications that are not always apparent in an MRI scan. Familiarity bias often leads to portfolios that are overly concentrated. Said differently, patients [clients] who suffer from familiarity bias are not adequately diversified enough. This results in a situation in which a portfolio is not optimally risk-adjusted and leads to decisions made in hast such as capitulating in a bear market and selling at precisely the wrong time: the selling climax. So how did we overcome our bouts of familiarity bias?
For one thing, we got older, which helped a great deal. But we also began to follow a disciplined investment process that has worked well over time. Of course, subtle refinements to the process can and must be made a long the way [over time governments change, interest rates shift and technologies evolve] but no matter what we might be feeling personally, we know now to never question our overall process. Perhaps that's the true benefit of wisdom acquired through age.
If you or someone you know has intimate feelings about a company, please feel free to call us at 1-866-367-3040. We will help you set the record straight, after all bringing your portfolio to safety starts by first realizing the dangers you hold.

Firm News

MAAM Portfolio Managers were in New York last week for meetings with private equity and digital media partners.

March 1st, 2019 is the deadline to contribute to your RRSP for the 2018 tax year so don't be late!

MacNicol & Associates Asset Management Inc.