MacNicol & Associates Asset Management Inc., 130 Bloor Street West, Suite 905, Toronto, Ontario, M5S 1N5

June 2019

The Monthly

With this commentary, we plan to communicate with you every month about our thoughts on the markets, some snapshots 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 production of too many useful things results in too many useless people"

- Karl Marx

The Numbers:

Index:		**Year-to-Date:**
S&P/TSX:		13.4%
NASDAQ:		12.3%
Dow Jones:		6.4%
S&P 500:		9.8%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	1.68%	2.40%
5-Year Bond:	1.55%	2.18%
10-Year Bond:	1.66%	2.40%
30-Year Bond:	1.89%	2.83%

Economic Data:

- Canada adds 27,000 jobs in May ahead of economist expectations of only 5,000
- The May US non-farm payroll of 75,000 signals the end of 200,000+ monthly job gains
- The US yield curve is flat as the spread between 90 day and 30-year US Treasuries nearly at zero
- Crude Oil experiences full blown bear market
- Gold makes quick work of the $1,300 level in early June, currently valued just below $1,350
- Eurozone in tatters: the EU set to study Italy's finances with a focus on debt, Germany's industrial output sharply lower in May, ECB on hold

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	21.37	22.33
P/B: Price-to-Book	3.38	3.25
P/S: Price-to-Sales	2.14	2.10
Yield: Dividend Yield	1.91%	1.85%

Year-to-date Performance, by Sector: June 4th, 2019

S&P/TSX Composite	13.4%
NASDAQ	12.3%
Dow Jones Industrials	6.4%
S&P 500	9.8%
Russel 2000 (Small Caps)	8.7%
MSCI EAFE	5.7%
Crude Oil Spot (WTI)	18.5%
Gold Bullion ($US/Troy Ounce)	1.5%
SOX Semi-conductor Index	12.9%
VIX Volatility Index	-23.7%

Source: Thomson Reuters

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 June 7, 2019 4:00 PM	$5,000	Cdn		
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.327	$3,768	$1	0.0%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.3398	$3,732	$(35)	-0.9%
Raymond James	1.3450	$3,717	$(50)	-1.3%
Royal Bank	1.3581	$3,682	$(86)	-2.3%
Scotia	1.3635	$3,667	$(100)	-2.7%
TD	1.3610	$3,674	$(94)	-2.5%
Spot Rate	1.3272	$3,767		

See Saskatchewan from the top of a chair…but not before a pancake breakfast…



I love pancakes, most people do. Pancakes are delicious, satisfying and a magnificent breakfast to enjoy before a day of sight seeing. They are also flat. Really flat. So flat is my guilty breakfast pleasure that they take me back nearly 20 years to an evening I spent at the Yuk Yuks Comedy Club in downtown Toronto. In one particular act a comedian was making an affectionate mockery of the great Canadian province of Saskatchewan. The punch lines took aim at – what else - Saskatchewan's flatness. Now somewhere midway through my first beer the comedian talked about ways in which he could help increase tourism in Saskatchewan by coming up with new more catchy/trendy license plate slogans that adorn the province's cars. The idea was Saskatchewan really was boring but hey, why not check it out.

"*See Saskatchewan from the top of a chair*" and "*Saskatchewan…where we measure distance in hours*" were my two favourites. You would certainly need a hearty pancake breakfast if an hours long drive to were in store for you. Hearty breakfasts were nearly a requirement in our offices these past few weeks. The MAAM team has spent many hours studying developments in the bond market, which despite being bigger and way more important…tends to play second fiddle to the more entertaining stock market. Accordingly, in this edition of *The Monthly* the MAAM team explores what may lie in store for investors during the second half of 2019 if you think big.

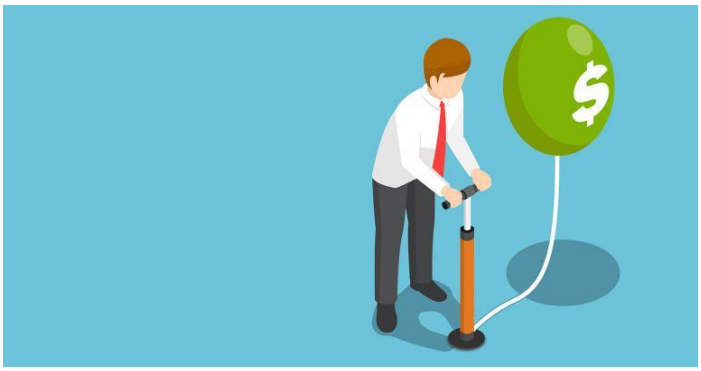
But before we do that, an aside. In preparing for this edition of *The Monthly* we took a few moments to educate ourselves about the earth's other really flat places. It was a worthwhile tangent (I will gladly kill 10 minutes to learn something I didn't know before). According to Redbull.com which we admit is not Haver Analytics or the Bureau of Economic Research the flattest places on earth are as follows:

1. The mudflats in northern Germany's Schleswig-Holstein Wadden Sea National Park
2. Salar de Uyuni, Bolivia (world's largest salt flats)
3. The Danakil Desert, Ethiopia
4. Florida Everglades, Florida, USA
5. The Maldives, Indian Ocean
6. Lake Baikal, Siberia
7. Cloncurry, Australia
8. Bonneville Salt Flats, Utah
9. Makgadikgadi Salt Plains, Botswana
10. Wadi Rum, Jordan

Notice anything strange? Saskatchewan is missing. Speaking of missing, when it comes to yield curves, what is missing is slope.

Our friends at Haver Analytics recently updated a chart we feel might be quite interesting for investors to look at. The chart compares the difference between long-term yields on the U.S. 30-year treasury note and short-term yields on the U.S. 90-day treasury bill. Portfolio Managers term this difference the "spread" and use it to analyze something called the "term-structure" of interest rates. The term structure of interest rates is the relationship between bond yields of different maturities. The idea is one gets to build a model of what bonds of different maturities are paying to investors. Connecting the dots in this model nets you a line called the yield curve. The *shape* of the yield curve (especially its slope) reflects the expectations of investors about the future of interest rates, monetary policy conditions and the economy.

Normally, yield curves are upward slopping: the yield on a 30-year U.S. treasury bond is typically **more** than the yield on a 90-day U.S. treasury bill and there's a good reason why. As a buyer of U.S. treasuries, you are effectively lending money to the U.S. government. If you lend the U.S. government money for a short period of time, then you can expect to be repaid in full a short while later along with a token amount of interest for your trouble. If you lend money to the U.S. government for a long period of time, then you can expect to be repaid in full a long while later along with a larger amount of interest for your trouble and added patience. Why the juicier yield for more patient investors? Well the idea is that in a healthy economy there's bound to be a bit of inflation looming around every corner silently eating away at investor capital. Over short periods of time like a week, you will not likely even know its there. But over longer time periods like a decade, inflation will just about slap you in the face.



[Inflation is often painted black by the investment profession. That idiom can seem self serving but it underpins the *central* reason why it is essential to save for one's future. Proper inflation delineation is good information: in any healthy economy a certain base level of inflation is normal. Its really only when inflation explodes do Republics crumble and currencies drop like a stone]

But what about when inflation is *not* exploding? What about when inflation is barely present at all? In these situations, rates across the yield curve converge signaling to investors that inflation and economic growth are likely to **remain** muted for some time. There is little enthusiasm for ongoing improvements to economic prosperity visa vie innovation and the willingness of banks to lend is weak. An economy without inflation is like a patient without a pulse. The chart from Haver Analytics then shows us that the bond market feels the economy is getting tired. Naturally, President Trump doesn't seem to agree with the bond market. Trump recently rhapsodised about how America's current economic boom was so strong and so unprecedented that it is making the rest of the world prosperous too. While a variety of *individual* risk factors can be singled out by investors as reasons to stay vigilant (all of them good ones by the way) the MAAM team believes the most important *one* is that the economy just is not as strong as we thought it was 18 months ago. In this type of environment our recommendation for investors is to stay defensive and stay diversified. Real estate, utilities and consumer staples are sectors we are more constructive on in this low growth low environment. Gold bullion and select gold equities which did not do a heck of a lot during the first part of 2019 look a lot more appealing today. Technology is central to growth but avoid companies that mascaraed as discretionary or quasi discretionary retailers. The big push in tech is data and artificial intelligence, especially in areas where it can be applied to scalability or predictive modeling. Alternative Assets are part of a well diversified, balanced portfolio. Cruise through life without an allocation to alternative assets and your portfolio is missing some key players.

The yield spread chart from Haver Analytics is not quite in a zone that makes stock markets do some challenging things but if you ask us the future for safe guarding capital is now and like always we are not taking any chances.

The MacNicol Investment Team

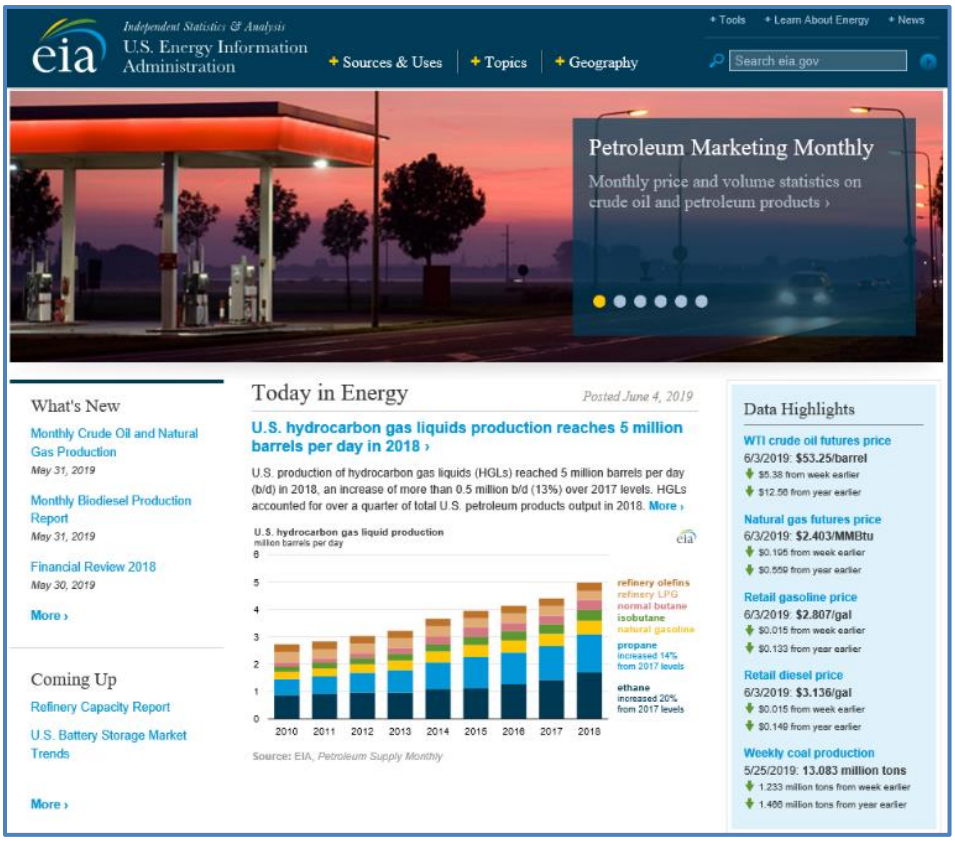
See the forest *and* the trees…

Years ago, I worked for an investment firm that focused on dividend paying stocks. One of the largest bets was the energy sector, which I found a little weird. Resources stocks were volatile I remember saying to myself. Nonetheless, I figured that with such a heavy weighting to such a volatile sector I better do some extra homework to learn as much about energy companies as possible. And I did. I learned about the various operating metrics one needed to assess when scrutinizing energy companies like operating netbacks, depletion rates and the important EV/EBITDA ratio[1]. I also got to know more about the various energy producing regions in North America like the Permian, Eagle Ford, Bakken, Duvernay and Montenay. And I spent time reading research reports, economic updates and corporate filings. Having spent time at a firm that made large "bets" on a single sector ultimately proved useful to me: when a lot is riding on something, you're bound to pay attention. The energy sector is extremely capital-intensive. Capital *intensive* means it can cost millions and sometimes billions of dollars to: buy equipment, finance new projects or take over a competitor. Understanding individual

energy companies was certainly (a) requisite for generating returns and managing risk in this frenetic sector but so was a broader perspective. And herein lies the one thing that my friends at the former dividend firm missed: energy companies were able to pay dividends in those days because they were dripping with cash. Cash that came from operations producing lucrative petroleum by products although many companies generated dividends through capital raises.

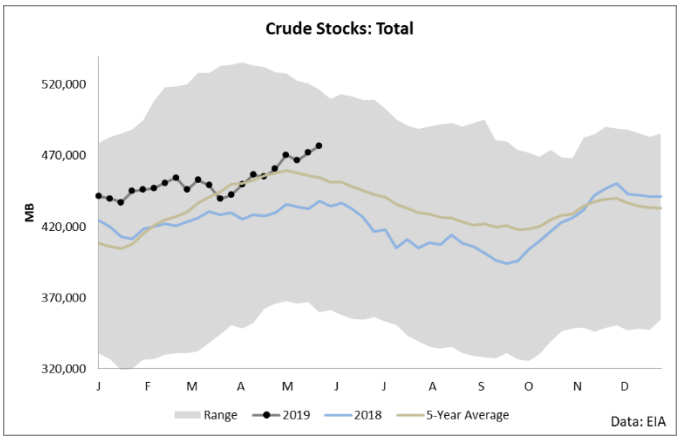
The thing is energy prices are not *always* high…neither are dividends…

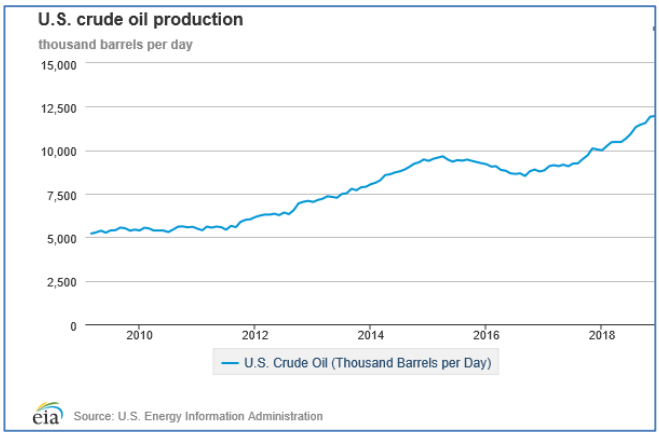
Dividends are a fairly simple matter unless you happen to chair a corporate board. Once a decision to make a dividend payment (worth millions of dollars) is made the money is gone for good. More importantly, once investors get into the habit of receiving dividends from you, they tend to expect them. Making the decision to suspend (or cancel) a dividend payment like say for example, when the price of the thing you produce plunges, is agonizing. To reduce agony and hopefully explain what has gone on in the energy sector the past 50 days what I thought I would do is share a little trick I learned back at casa dividend. Believe me, it really helped me see the forest *and* the trees. In 2012, I signed up for e-mail updates from the US Energy Information Administration (EIA). The EIA's home page is shown below, feel free to familiarize yourselves with it or simply call us if you want the "Coles Notes" version.



[The EIA website has barrels of terrific energy information. Think of it as a hodgepodge of hydrocarbons that have been meticulously organized by a Petroleum Geologist or Engineer]

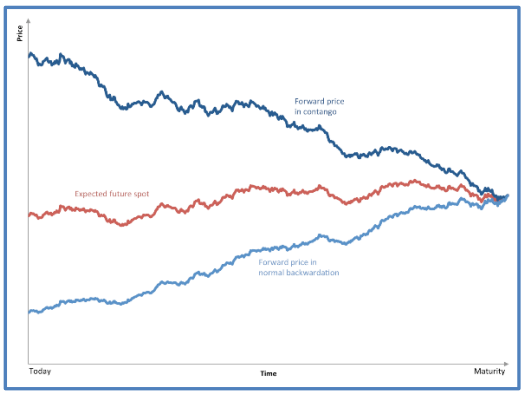
The EIA is the principal agency of the U.S. federal statistical system responsible for collecting, analyzing, and disseminating energy information. Primarily a tool for energy policy making the EIA is truly a magnificent resource for investors as well. Let's take a closer look at some of the things the EIA website has been featuring more recently.





[The bear market in crude oil prices began in April 2019 and caught many investors off guard. Consistent with a slowing global growth narrative, Crude Oil stock piles broke loose from their 5-year average and now approach the upper end of their long-term trading range. Not helping matters is the chart on the right showing that energy companies are getting better at finding and extracting crude oil than they ever have. Not exactly two charts that support a "peak oil thesis" to us]

Globally, but especially in the United States, energy companies like those in the oil patch are getting a heck of a lot craftier at: finding, extracting and bringing-to-market their products. *Twice* as many barrels of oil are produced per day in America now than a decade ago and this - along with a few other things - are leading to a glut of supply. When oil, or any commodity for that matter, is over supplied the prospects for higher prices seem plausible but certainly not probable. But we worry about those "few other things" too. The EIA data in the chart above on the left confirms that the bear market in crude oil began in April and paralleled data showing crude stockpiles breaking loose from their 5-year average. The trouble is energy prices *continued* lower in what is traditionally one of its stronger periods: the summer driving season. Maybe its the weather, maybe its *Game of Thrones* but one thing is for certain: we hope more and more North Americans hit the "open road" this summer even if its in vehicles that are now doubly as fuel efficient as their ancestors were. Cutbacks in capital expenditures and mandated capital discipline enforcements could reign in production allowing inventory levels to grind down a bit but that could take a while in a low growth world full of efficient fuel misers. As you can probably tell we are not raging energy bulls at MAAM. Supply/demand fundamentals between producers and users of energy isn't the only thing making us self conscious about this sector. Futures markets also guide us towards caution.



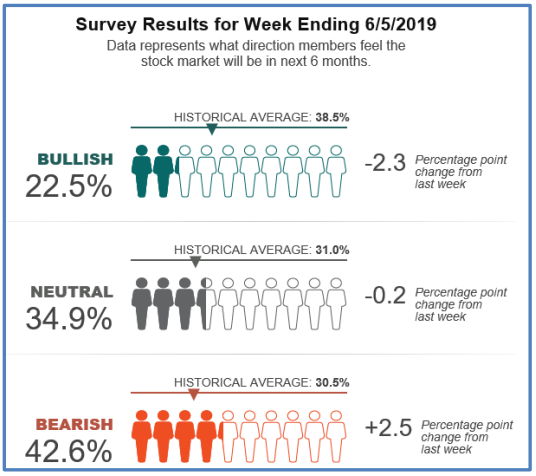
[Most of the time, futures markets are in Contango. Contango occurs when the front-month contract is less expensive than contracts dated further out. Let's say January oil futures are trading at $40, February oil futures are $45 and March oil futures are $50. Since each month's futures contract is trading lower than the month that follows, this market is said to be in Contango]

Futures contracts have a tendency to slowly approach the price of the front-month contract as time progresses (this is why they are called *futures* contracts). Roll yield is the return a trader can get by rolling a shorter-term futures contract into a further out futures contract. When the market is in Contango (like now) roll yield is negative because positions in later months will decrease in value relative to positions in the front of the curve. Contango indicates that the market is oversupplied and corroborates EIA data as to the ongoing weak fundamentals in the energy sector.

Knowing everything there is to know about a company or companies in the weakest performing sector of the economy simply means you stand to lose the least. At MAAM our mandate is to safeguard client wealth but also to grow it. We never engage in a race to the bottom with your capital and with our collective experience and independent professional judgement we can help you see the forest *and* the trees.

Financial Endorphins: small rocks making big waves

Financial endorphins are data points that make investors feel good. They are especially nice after a period of psychological oppression as an investor. Lately investors have been feeling down. Investor sentiment has plummeted over the past month and the American Association of Individual Investors (AAII) survey showed that just a quarter of respondents were bullish on stocks in the short-term. That is less than the historical AAII print of about 40%.



[The American Association of Individual Investors. Because feelings matter]

But that all changed this past Tuesday. Noted Technician Andrew Adams, CFA, CMT quipped that the market has bottomed and is now set to saunter forward. Adams sites the breadth, depth and robustness of the Tuesday reversal as the basis for his thesis that the worst is over in 2019. Stocks in many sensitive areas like semi-conductors and the small cap space all pivoted sharply Tuesday. High yield bonds and investments in emerging markets u-turned too. It was as though the market reached a point of maximum pessimism and is now poised to provide a better environment for almost all investments. This is good and one of the reasons why tossing a small rock into a large (calm) lake can make waves both in periods of depression and complacency.

It is good that the weather isn't the only thing improving in Toronto: markets are picking up and that means Toronto investors can enjoy some sun and hopefully a Toronto Raptors…well…you-know (we certainly don't want to jinx it) and wait till you read our firm wide news announcement. A common tendency among investors is to throw in the towel at precisely the wrong time and miss the next leg up. If you are feeling pessimistic, speak to us. Just because safe harbour investing is a way of life around here, doesn't mean we don't have things to feel good about.

Firm News

We are excited to announce that Naima Egal gave birth to a healthy 9.4-pound baby girl named Layla. This is the third child for Naima and her husband Latif.

Congratulations Naima!

MacNicol & Associates Asset Management Inc.