April 2019

The Quarterly

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.

"To know values is to know the meaning of the stock market."

- Charles Dow

The Numbers:

Index:		Year-to-Date:
S&P/TSX:		8.25%
NASDAQ:		15.58%
Dow Jones:		10.25%
S&P 500:		12.31%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	1.67%	2.41%
5-Year Bond:	1.59%	2.32%
10-Year Bond:	1.73%	2.51%
30-Year Bond:	1.99%	2.92%

Economic Data:

- Q1 2019 a rebound quarter for markets world wide
- Yield curves flatten further in the quarter garnering attention from investors and policy makers
- Gold was strong earlier in the quarter but sold off in February and March
- Crude oil was higher the entire 1st quarter with WTI surpassing the $60 and Brent over $70
- Following a series of cooler economic results earlier in the quarter, industrial production in China picks up steam
- BREXIT discussions add an element of uncertainty to the Eurozone with the euro weaker in Q1'19

Valuation Measures: S&P 500 Index

Valuation Measure	Latest	1-year ago
P/E: Price-to-Earnings	21.6	22.5
P/B: Price-to-Book	3.43	3.17
P/S: Price-to-Sales	2.18	2.10
Yield: Dividend Yield	1.86%	1.85%

Year-to-date Performance, by Sector: As at Mar 31st, 2019

U.S. Markets	Close	Net	1 Day % Chg	YTD %
Dow Jones	25717.46	91.87	0.36%	10.25
Dow Jones Transports	10,319.63	121.99	1.20%	12.53
Dow Jones Utilities	774.06	-9.68	-1.24%	8.57
S&P 500	2815.44	10.07	0.36%	12.31
NASDAQ	7669.16	25.79	0.34%	15.58
Russell 2000 (Smallcaps)	1535.10	12.87	0.85%	13.83
BKX (Banking)	93.55	1.09	1.18%	9.04
BTK (Biotech)	5025.90	51.11	1.03%	19.07
XOI (Oil Index)	1305.00	-1.27	-0.10%	12.59
SOXX (Semiconductor)	1373.80	-2.68	-0.19%	18.93

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 April 24, 2019 12:00 PM	$5,000	Cdn		
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.3462	$3,714	$(11)	-0.3%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.3360	$3,743	$17	0.5%
Raymond James	1.3660	$3,660	$(65)	-1.8%
Royal Bank	1.3731	$3,641	$(84)	-2.3%
Scotia	1.3785	$3,627	$(98)	-2.7%
TD	1.3796	$3,624	$(101)	-2.8%
Spot Rate	1.3421	$3,726		

A modern-day interpretation of Dow Theory that left us feeling a little cold…

I was lucky enough to spend the 2019 March Break in Orlando, Florida. The weather was perfect in every way and daily text messages from freezing Toronto made Florida's sunny delight even more sublime. The other thing that (secretly) gave me pleasure down south was the dramatic - and expanding - college admissions bribery scandal. I rarely delight at the misfortunes of others but indulging in this particular scandal proved far too tempting. At issue were millionaire Hollywood actors and other prominent members of the Hollywood "establishment", as well as, the rich legal and finance people who should have known better. Sadly, in attempting to grease the hands of the lowest bidder, the main characters of this scandal not only undermined the value of a post secondary education, they undermined the value of hard work. Undermining the value of hard work creates a dangerous lesson in young minds: if Mom and Dad are rich, then why should I bust my butt? In attempting to "pave the way" for their kids with brides, the parents involved in the bribery scandal did their children a great disservice. By alerting the world to the idea that they themselves did not have faith in their kids' abilities these parents squandered the one true investment in this world that pays off the most. Kids are amazing and by teaching them that being independent gives one a greater sense of accomplishment and purpose than does being "handed" things much, much more is accomplished than by "handing" them material possessions or teaching them that adversity can be slowed with a wire transfer. In any event, heads will undoubtably role, Lawyers will duke this one out in court and for all its soggy weather and crippling traffic congestionI am happy to be in Toronto.

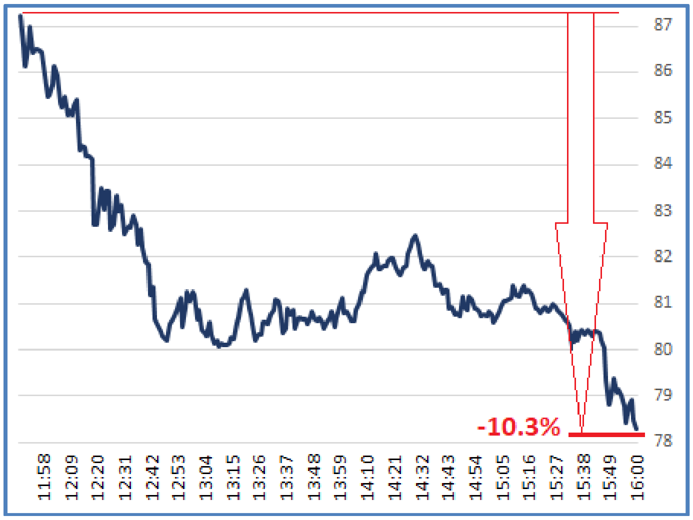
Happy, but feeling a little cold and the weather had nothing to do with it. Something about the economy and about markets bothered me, which was strange. Investment markets around the world had a wonderful 1st quarter; you name it and chances are it was up. British stock markets barely noticed the BREXIT going on or I guess *not* going on and other markets around the world performed very well in the first quarter after having been thrown under the bus just months ago. The weakness in December of 2018 (the worst December ever) I am sure has much to say about the initial performance of the 2019 campaign, but I really hope investors are doing their homework and paying attention to valuations. What better person to help remind of the importance of focusing on value than **Charles Dow**…

[Charles Dow was not a Lyft driver and "*call me an Uber*" would be absolutely nothing to him. That's because Dow lived over a 100 years ago…things were different back then…sort of]

Dow's belief on the markets and the health of the economy were communicated to the world in a series of editorials that ultimately became known as **Dow Theory**. Dow believed stock markets were a reliable measure of economic conditions and that by studying the broader market one could obtain unique insight into the economy that would in turn result in the ability to select individual stocks more effectively. Dow used his theory to create the **Dow Jones Industrial Average** and the Dow Jones Rail Index, which now goes by the name **Dow Jones Transportation Index**. Dow created these indexes because he believed that industrial activity and transportation volumes were inextricably linked and an accurate barometer of economic health. The index constituents have changed over the years (do you know anyone that still owns a gramophone?) but the basic concept has not: **Dow Theory** sell signals are classic harbingers of actual concern.

In this edition of *The Quarterly* we thought we would examine things from a more *modern* perspective while paying homage to the Dow Theory's classical roots. We begin with something of a modern-day transportation index of our own. Concentrated as it might be, the MAAM investment team feels that ride-sharing behemoths Uber and Lyft offer investors valuable lessons in valuations, the economy and common sense. Uber's IPO is forthcoming, but the world got its first taste of Lyft as a publicly traded company just recently when the tech "unicorn" began trading on the NASDAQ market.

Let's have a look and see how that went…



[The Lyft IPO didn't exactly go as planned. Sure…shares are rallying a bit (now) but do you *really* think a company that never made money before will do so just because they now have the added luxury (i.e. burden) of coping with life as a publicly listed company? At least with Netflix one can make the argument (not to us but in general) that investors are paying big bucks upfront for a library of films that will reap cash flows for years to come]

Lyft was so grotesquely overvalued during its initial public offering that it began plummeting almost immediately. They might as well have named the company *Lead*. That "unicorns" and money losing companies were viewed homogenously by investment bankers underscores our earlier feelings that perhaps earning an MBA Degree from Harvard or Yale *should* be hard. I wonder how many 30-year old Analysts and Portfolio Managers actually believe that borrowing money for 5-years to buy at house at 3.50% is a symptom of a "strong" economy?

[Unicorns exist mainly in your dreams, but they also exist on Bay & Wall Street where $1 Billion+ valuations for new tech start ups are not that uncommon. As beautiful and majestic as they are, we question whether the earnings of these so-called unicorns will meet expectations]

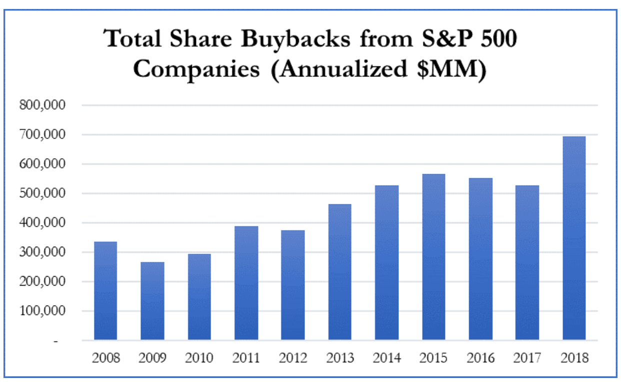
Maybe ivy league MBAs *aren't* hard enough…

Back to the inspirational Charles Dow. If companies like Uber and Lyft are viewed as new generation transportation companies, then they certainly drop off a chilling picture of markets and the economy. When these companies and others like them fall well short of their intended destination I hope investors will finally take note. Over levered consumers who are not traveling around the city as much because they just cannot afford to and over valued companies that cannot sustain their opening week hype on the stock market give me the shivers and I'm sure Charles Dow would have felt the same way.

At MacNicol & Associates Asset Management we know the difference between hype and a paradigm shift is sometimes enormously difficult to delineate, which is why we often turn to the past when attempting to draw out a more precise vision of the future. Charles Dow will never know the ease with which one can summon a vehicle. Dow will also never know the crushing burden that a mountain of debt can have on your life. Technological innovation has made life simpler, but it has also made parting with your money simpler too. Parents should not wait long to teach their children the value of hard work, but also the value of keeping more of what you make. We began this edition of *The Quarterly* with a quote by Charles Dow "*To know values is to know the meaning of the stock market*" and we think that over time more investors will. Maybe then, we will begin to feel a little warmer…for now though…we'll leave our phones in our pockets and just walk…besides the weather is beginning to look a bit better.

The MAAM Investment Team
Stock buybacks by the truck load…

We have written about stock buy backs before. Buybacks are not an especially enjoyable topic for us to write about, but we thought that resurrecting the issue with a fresh perspective might be healthy. First let us get a sense for the scope of share buybacks among S&P500 companies.



[$700 Billion is a lot of money. The End]

Large US firms are certainly no strangers to loading up on shares of their own stock. The right bar in the table above shows that 2018 narrowly missed the $700 *Billion* mark, but don't worry, if the trend continues 2019 will be another record for share buy backs. Buy backs *can* signal that a company's growth prospects have run aground but they do not necessarily have to. Another way to think about stock buy backs is to view them as the result of perceptive management teams enhancing shareholder value albeit only in certain, specific situations. For now, let us agree that stock prices can become dislocated from underlying company fundamentals and who better than management to know a company's true value. Management teams that are supportive of a company's stock price are a good thing.

At issue though is knowing when stock buybacks should be appreciated and when they should be demonized. Management teams may very well have the best intentions of shareholders in mind when they engage in share buybacks, but with so much money at stake these things are best handled with precision.

[Pick up trucks are great for hauling and towing but should never be used to dump corporate cash into share buybacks unless some careful analysis is done first]

Speaking of demonizing stock buy backs, Senators Bernie Sanders and Chuck Schumer recently tabled a plan to sequester the amount of their own share's companies can buy back. Sanders and Schumer add heft to a growing movement of politicians looking to reign in share buybacks. And then you have people like Senator Tammy Baldwin who wants to get rid of share buybacks entirely.

[Stock buy backs are no longer just an issue for corporate boardrooms. The debate now rages on in political circles…sometimes hopelessly so]

The MAAM investment team views share buy backs strategically: they are not a "core" business strategy though they can be a good use of shareholder capital on occasion. And outlawing them entirely would probably be a bad strategy in and of itself. Eliminating share buybacks would strong arm corporations into funneling cash elsewhere. In the mean time, per share earnings growth would slow or stall because aggregate earnings growth follows EPS growth with a lag since buybacks boost EPS by reducing the number of shares outstanding in the market place over time. Goldman Sachs reckons that the gap between earnings growth and EPS growth for S&P500 companies have averaged about 260 basis points for the 15 years ended December 2018. So, would sequestering the extent of buybacks lead to companies re-deploying capital back into their businesses? We are not so sure. Most management teams would probably increase cash allocations to things like dividend payments which we of course have no problem with. But they might also fund larger (and riskier) M&A (merger and acquisition) transactions. Mergers have hundreds of moving parts including one extremely difficult one to predict, which is that combining two corporate entities will ultimately give your clients more of what they want and less of what they don't. Merging with or taking out a competitor *purely* because you are not allowed to buyback your own stock is an ambitious, but risky, alternative to; dividends, capital expenditures and research.

In the matter of pumping money back into a business to make it better data shows that during the past decade capital expenditures and R&D have accounted for roughly $0.45 of every dollar of S&P500 spending, which equates to roughly 8-10% of sales. If attractive ventures exist, then we support corporations pursuing them. But we believe firms are unlikely to spend materially more than 10% of sales on capital expenditures and R&D simply because they cannot spend them on R&D.

The long-term damage from an ill-conceived merger aside, one must ask how many times corporate boards have stepped in to "save" a sagging stock price? Goldman Sachs strategist David Kostin suggests that putting the brakes on buybacks would put the brakes on much of the smooth sailing we have seen in recent years. Kostin specifically notes that a greater amplitude (oscillation from a position of equilibrium) would befall a world in which stock buybacks were outlawed. Certainly, the return dispersion of indices like the S&P500 is broader during buyback "blackout" windows. But the MAAM investment team is left wanting for more…

[The issue of share buybacks leaves us feeling left out in the cold but not for reasons you might suspect]

Our view is that share buybacks have helped smooth out <u>some</u> of the market volatility that investors might have had to endure. But so too have ultra low interest rates, a flood of monetary liquidity and a Central Banking regime that seems to take its cues from the market (especially recently). That's in addition to the fact that our safe harbour approach to investing begins and ends with a focus on what is the right level of risk for you, and what is a stock's underlying intrinsic value.

If more corporate boards focused on understanding the optimal amount of stock to buyback and at what price they should be doing it at then they would truly be benefiting investors. If a company is selling below its fundamental book-value, then share buybacks are definitely worth the trouble – and should be encouraged. On the other hand, if a company's shares are trading above book value then share buybacks fundamentally destroy balance sheets and investor returns with them. Perhaps rather than arguing whether stock buy backs are "good" or "bad" politicians would be wise to take a college level finance course. Many corporate managers might attain the same benefit. Share buybacks do have some short-term benefits which we have outlined, but at the end of the day nobody wins when a company's shares are bought back at 2x, 5x, 10x or 100x their book value and shareholders usually lose.

The MAAM Investment Team
Caffeine and cost…

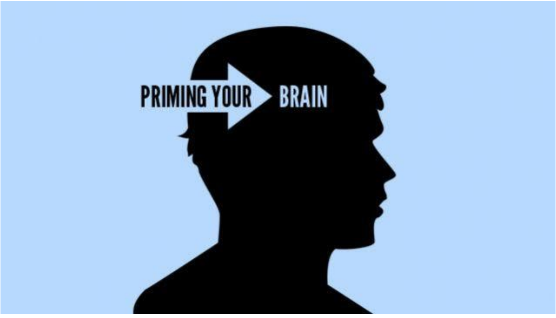
One of the things I love most about our new office location at **130 Bloor Street West** is that our firm now straddles the north east corner of the University of Toronto. There was something satisfying about walking through the heart of the campus on my way to work one morning. Speaking of satisfying, regular readers of *The Quarterly* will know that I am a huge fan of a coffee and capitulate to caffeine with surrender. Luckily, accordingly to University of Toronto Marketing Professor Sam Maglio, I no longer actually have to **buy** my daily dose of high-octane "Portfolio Manager's juice" I can simply view images of java on my smart phone to remind me that coffee can cause me to become more alert and attentive.

[University of Toronto Marketing Professor Sam Maglio stumbled onto something I have long suspected]

Professor Maglio and his colleague Eugene Chan of Monash University studied something called the **priming** effect in which exposure to even subtle cues can influence our thoughts and behaviors. In the investing world **priming** can prompt investors to take on too much risk too late in a trade. Always be weary of buying what others are selling. When your friend or neighbor tells you about the latest wiz-bang tech stock they bought and are profiting from, be reminded of the expression "The average overnight success took a decade to achieve".

[Dan Aykroyd's sunglasses and expensive sport coat in *The Great Outdoors* primed you to believe that "Uncle Roman Craig" was a scion of business and investing]

There's now scientific research behind that pleasant feeling you get when you look at a cup of coffee. But buying the latest tech start up your neighbor mentioned may simply prime you for failure. Working with MacNicol & Associates Asset Management may not guarantee you a fancy sport coat like "Uncle Roman", but the coffee we actually serve is delicious.



If you have a stock you are "primed" about (but want a second opinion about just in case?) we are glad to help e-mail us at info@macnicolasset.com.

Firm News

MacNicol & Associates Asset Management is pleased to announce that we have officially moved into our **new offices located at 130 Bloor Street West**, Suite 905. If you haven't already, please update your contact information details for us now.

Brook Pickering has been our Portfolio Administrator for the past two years. Brook has decided to relocate closer to her Mother's farm in Ottawa where she will also be closer to her horses. Over the past two years, Brook has built meaningful relationships not only with our clients, but also our advisors and staff. Brook is an extremely hard worker and has help move our administration processes forward. We will certainly miss her and wish her the best in her future endeavors. Hopefully our paths will cross again in the future.

MacNicol & Associates Asset Management is pleased to announce that Fabiane Gaion will be joining the firm in April in the role of Portfolio Administrator. Fabiane brings experience in public sector accounting and the not-for-profit sector and she looks forward to working with MacNicol clients soon.
MacNicol & Associates Asset Management Inc.