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

March 2020

The Monthly

See Page 12 for our comments about today's Market volatility.

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.

"Everyone has the power to follow the stock market". "If you made it through fifth grade math, you can do it"

- Peter Lynch

The Numbers:

Index:		**Year-to-Date:**
S&P/TSX:		- 4.7%
NASDAQ:		- 4.5%
Dow Jones:		- 11.0%
S&P500:		- 8.6%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	1.30%	0.98%
5-Year Bond:	0.93%	0.81%
10-Year Bond:	1.00%	1.06%
30-Year Bond:	1.26%	1.65%

Economic Data:

- US Federal Reserve cuts rates by 50 basis points
- G7 Finance Ministers plan high level coordination but opt against specific policy action
- Stocks face a wild ride in late February with the Dow Jones Industrial average giving back 1,031 points on February 24th, 2020, the 3rd worst point drop ever.
- US 10-year Bond yield trades below 1%
- OPEC production spills Crude Oil lower in late February to $45/bbl
- Copper stable in the $2.50's through-out February
- Gold nearly kissed $1,700 on February 24th, 2020

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	23.1	20.9
P/B: Price-to-Book	3.4	3.3
P/S: Price-to-Sales	2.2	2.1
Yield: Dividend Yield	1.89%	1.99%

Year-to-date Performance, by Sector: February 28th, 2020

S&P/TSX Composite	- 4.7%
S&P/TSX Venture	-13.8%
NASDAQ	- 4.5%
Dow Jones Industrials	- 11.0%
S&P 500	- 8.6%
MSCI EAFE	- 11.2%
Crude Oil Spot (WTI)	- 22.9%
Gold Buillion ($US/Troy Ounce)	4.4%
VIX Volatility Index	130.33%

Source: Canaccord Genuity Capital Markets & 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 March 9, 2019 9:20 AM	$5,000	Cdn		
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.3617	$3,672	$(54)	-1.5%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.3750	$3,636	$(89)	-2.5%
Raymond James	1.3800	$3,623	$(102)	-2.8%
Royal Bank	1.3905	$3,596	$(130)	-3.6%
Scotia	1.3769	$3,631	$(94)	-2.6%
TD	1.3961	$3,581	$(144)	-4.0%
Spot Rate	1.3421	$3,726		0.0%

Communication breakdown, a killer of marriages and revenant Bull Markets…
But ultimately solvable by a 5th Grader

Late February's stock market action has the dubious distinction of having set a number of dastardly investment records. We will avoid rehashing the painful plethora of horror stories here as many investors continue to lick wounds. At the same time some market stats made even our eyes water and had us thinking "Lehman moment" if only for a few hours. For instance, have a look at the yield on the US 10-year note. We *do* reference lending the US Government money later on…

[We were of the opinion that the bond market topped during the summer of 2016, but that view has changed especially when one considers that investors are literally tripping over each other in their flight to quality and safety.]

Cue the re-active ensemble of Politicians and Central Bankers…

As though they were members of a Broadway Musical, G7 Finance Ministers and Central Bankers have either weighed in on what to do about the potential economic impact of the Coronavirus or at the very least put in place a timeline to address the issue. Simply hearing the media report that "something" is in the works appears to be good enough to stabilize markets which of course makes that "something" - and how it gets communicated - very important. As we write you this letter, the US Federal Reserve (the Fed) has implemented a 50 basis points (or ½ of 1%) "emergency" rate cut. "Emergency" is more of a machination of the financial news media. We read the entire FOMC statement [included below] and listened to Chair Powell's entire news Press Release and not once did we observe anyone at the Fed use the term "emergency".

Press Release

March 03, 2020

Federal Reserve issues FOMC statement

For release at 10:00 a.m. EST

Share

The fundamentals of the U.S. economy remain strong. However, the coronavirus poses evolving risks to economic activity. In light of these risks and in support of achieving its maximum employment and price stability goals, the Federal Open Market Committee decided today to lower the target range for the federal funds rate by 1/2 percentage point, to 1 to 1-1/4 percent. The Committee is closely monitoring developments and their implications for the economic outlook and will use its tools and act as appropriate to support the economy.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michelle W. Bowman; Lael Brainard; Richard H. Clarida; Patrick Harker; Robert S. Kaplan; Neel Kashkari; Loretta J. Mester; and Randal K. Quarles.

For media inquiries, call 202-452-2955.

[This is the official press release from the US Federal Reserve along with a telephone number for media inquiries. We doubt many members of the media used the number since the word "emergency" is no where to be found in the statement. Sloppy journalism.]

But the fact remains that the Fed cut rates by 50 basis points, which has the perception of being some type of "emergency" measure put in place to support a fundamentally weak economy. But then, the US economy is not fundamentally weak it is fundamentally strong. The Fed even says so in the first sentence of their news release.

Ladies and gentlemen buckle up…its going to be a bumpy ride…

[During his 41-year career famed Lufthansa Chief Pilot Juergen Raps would have encountered turbulence numerous times. Yet Captain Raps' passengers enjoyed smooth sailing for over four decades, which meant: he had faith in his equipment, the knowledge to apply it effectively and just the right dose of experience to know whether to fly through a storm cloud or around it.]

While the Fed has acted, in a somewhat perplexing way. The European Central Bank (ECB) is set to delivery its own views on monetary policy along with any adjustments they deem appropriate. By now you will already know that the Bank of Canada has already indicated that it judges the risks to their growth outlook as having changed materially enough - in light of the Coronavirus and many of the world's other problems – to warrant a rate cut of its own. The Bank of Canada cut its key benchmark interest rate by 50 basis points Wednesday morning over concerns about what the Coronavirus could do to the economy and while we hope more care is put into the messaging around that policy action we will not be able to report on it until the next edition of *The Monthly*. For your information the next heavy-weight Central Bank to officially weigh in will be the ECB on March 12th, 2020 and yes you can bet we will tune in to watch ex-IMF Boss Christine Lagarde in Act 1, Scene of her campaign with the ECB. The Bank of Japan, Bank of England and the Swiss National Bank are all set to meet later in March. While not generally risk takers, we would venture to guess the [easing] action is the same though the message hopefully different.

And now some 5th grade mathematics…

Legendary investor Peter Lynch kicked off *The Monthly* by stating that everyone has the power to follow the stock market and while it may not necessarily be child's play to observe 1,000-point fluctuations in the stock market, an independent perspective might help.

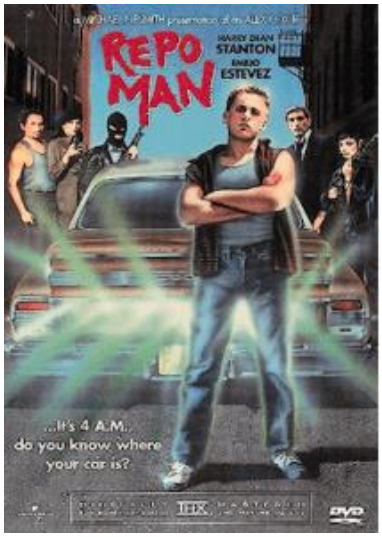
Date	Dow Jones Industrial Average	Percentage Change	Point Change	Rank Based on Percentage Change
October 15th, 2008	8577.91	-7.87%	-733.08	12th
December 1st, 2008	8149.09	-7.70%	-679.95	15th
October 9th, 2008	8579.19	-7.73%	-678.92	16th
September 17th, 2001	8920.7	-7.13%	-684.81	21st
September 29th, 2008	10365.45	-6.98%	-777.68	24th
February 5th, 2018	24345.75	-4.60%	-1175.21	112th
February 8th, 2018	23860.46	-4.15%	-1032.89	154th
February 24th, 2020	27960.8	-4%	-1031.61	254th

[The 1,031 point "swan dive" taken by the Dow Jones Industrial Average on February 24th, 2020 looked more like a Peregrine Falcon in full blown attack mode when viewed purely in the context of the number of points lost. But in the Dow's 124-year history, February 24th ranks as the 254th worst wealth implosion on record. If you contrast February 24th, 2020 to just about any date in-or-around September of 2008 you get the sense that this was no "Lehman moment".]

Being good at investing involves many things, but more than anything else it involves knowing who your clients are. At MacNicol & Associates, knowing who our clients are is something we never forget. Being good at a marriage also involves many things, but mainly being a good communicator. Some people are naturally good at communicating and knowing what others needs to hear. Others, like certain Central Bankers, need a little work. The good news is that with a little effort, and perhaps the suggestions of your average 5th grader, a good time can be had by all, and we can all just live in peace and harmony.

The MacNicol Investment Team

The Repo *Men*…



In 1984's *Repo Man*, Los Angles punk rocker Otto Maddox [played then by a 22-year old Emilio Estevez] is fired from his job but soon lands a gig working for an eccentric repossession agent. At first, Otto is reluctant to work as a repo man, but soon feels differently about the experience. Describing US Federal Reserve Chair Jerome Powell as eccentric would be one of those hilarious malapropisms that would elicit laughter.

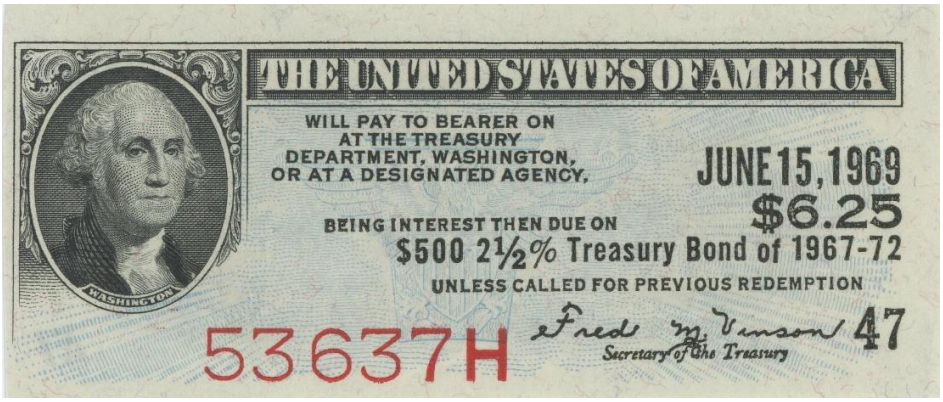
Eccentric? Not even slightly. Prosaic? Totally.

Though Maddox [Estevez] and Powell dabble in two completely different repo markets, the question that immediately comes to mind is whether Powell feels differently about his own existence within the repo world? Remember, the few hundred dollars Maddox reels in for vehicles pales in comparison to the trillions of dollars-worth of repurchase agreements Powell influences on a regular basis. It also quite a bit different. The repurchase or "repo" market is an arcane but unbelievably important part of the financial system that has come under increasing scrutiny by the media and investors recently. On average, $2 to $4 trillion worth of repurchase agreements or collateralized short-term loans are traded each day. A party selling securities to another party and agreeing to *repurchase* those same securities at a later (and higher) price is the definition of a repurchase agreement. The securities in question serve as collateral in these gigantic transactions and are most typically US Government Treasury Bonds. The spread or delta between the initial sale price of the securities and their subsequent repurchase is the interest paid on the loan or what becomes known as the repo rate. The reverse of this exercise, a party buying securities and agreeing to relinquish them for a slight premium down the road (usually the very next day) is termed a reverse repurchase agreement.

Arcane but unbelievably important…

The repo market permits financial institutions that stock-pile securities like banks, investment dealers and hedge funds to *borrow* money cheaply (in order to avoid the hassle of chipping away at their respective inventories of securities) and it permits entities with tons of spare cash laying around such as money market funds and some asset managers to *lend* money (in order to avoid the cost of having too much of it laying around doing nothing) without taking on undue risk. Without

taking on too much risk because, as I mentioned, the securities in question are mainly US Treasury securities which serve as collateral.



[Have you ever purchased a US Treasury security before? If you have, congratulations: you have lent the US Government money. But don't worry, they are a very credit worthy borrower]

As an individual civilian you certainly want to have some cash handy at all times maybe even a little surplus for good measure. But as a financial institution you do not actually want to hold any more cash than is absolutely necessary, cash doesn't pay a lot these days. Take a gigantic hedge fund in New York or Greenwich. The fund will almost certainly own hundreds of millions (or billions) of dollars-worth of securities, but the majority are locked up invested even though the fund still requires the ability to finance daily trading operations. In this situation, the fund can access the repo market and borrow funds from a large money market fund or asset manager that is replete with cash and looking to put it to work.

["A gigantic hedge fund in New York or Greenwich, what utter bollocks". "Everyone knows the biggest hedge fund is right here in Washington, DC.]

The US Federal Reserve uses the repo market to conduct monetary policy. Specifically, when the Fed buys securities from a seller who agrees to repurchase them down the line, what it is in affect doing is injecting money (reserves) into the financial system. On the other hand, when the Fed sells securities it is emptying money (reserves) from the financial system. This activity is sometimes difficult for individual investors to grasp, so think of it this way: reserves are the amounts of cash banks have on hand at any given moment and the location of bank reserves is either in their own vaults or on deposit with

the Fed. Since the Fed sets the *minimum* level of reserves a bank must have anything above that number is the excess that banks can lend out.

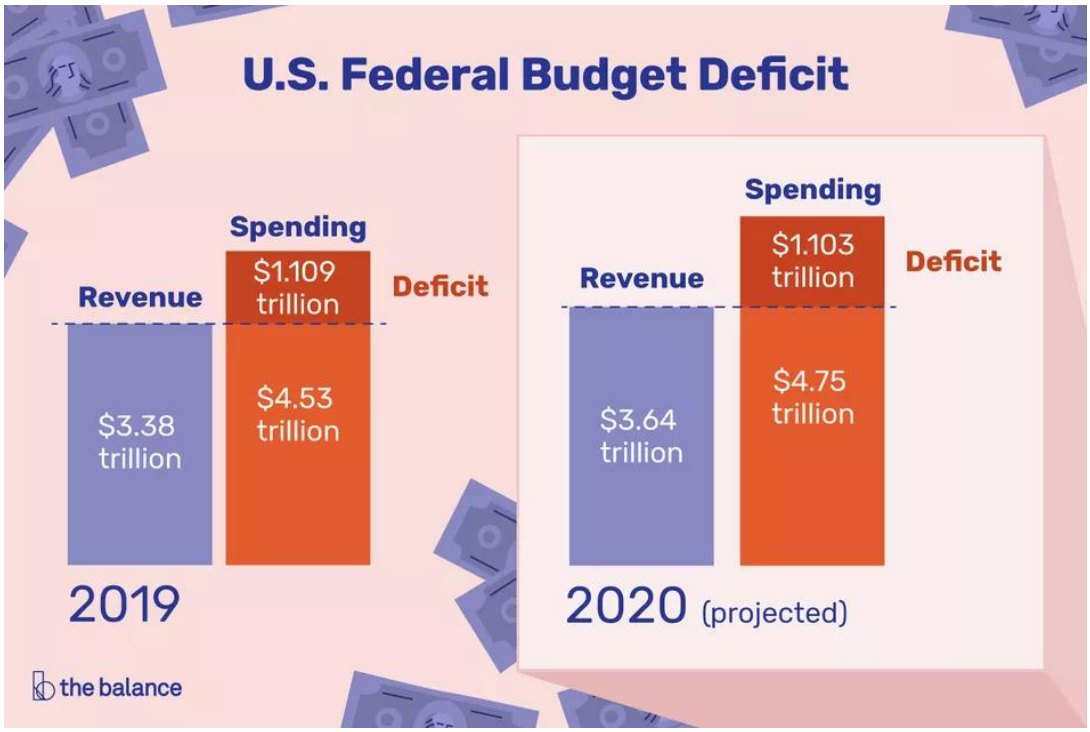
Remember, the Fed is the lender of last resort and large banks can lend or borrow from the Fed directly…you and I cannot. But what might cause Jerome Powell to feel differently about repo markets in his role as Fed Chair? Well back in September of 2019 and for some strange reason, repo rates temporarily shot up to as much as 10%. You might think that based on what I just explained, bank executives would be tripping over themselves to lend into such an environment. But you'd be wrong. Even banks that were flush with excess reserves refused to lend. What was stranger still was that repo rates generally trade in line with the Fed's benchmark Fed Funds Rate, which is the rate that banks can borrow and lend money to each other overnight. The Fed's *target* for the Fed Funds Rate was somewhere between 2% and 2.25% but the pop in repo rates led to a situation in which the effective Fed Funds Rate rose to 2.30%. Added nuance is found in Appendix A. But two things occurred in September that drastically increased demand for cash which is liquid versus securities which are liquidish but nevertheless must be sold to make payments. First, quarterly corporate taxes were due and second, that was the time period of the settlement for earlier auctioned US Treasury securities. This one-two punch of fiscal firepower resulted in a massive shift of reserves from the financial markets to the government, which created incongruence in the supply and demand for reserves. But there's more to it than that. In the days before the global financial crisis banks and the Federal Reserve operated in a reserve environment of relative scarcity: banks tried to hold on to the bare minimum amount of reserves needed and borrowed or lent any differentials to this amount. The Federal Reserve in turn replenished or drained reserves as necessary to move the fed funds rate back into its targeted range. Now between 2008 and 2014 the Fed was engaged in a bond buying program known as Quantitative Easing (QE), the basic premise of which was to stimulate the economy. The Fed spawned new reserves to buy securities with and dramatically expanded its balance sheet [a quick Google search is all anyone needs to experience the seismic shift of reserves in the banking system]. In any case, the pre-Lehman Brothers era framework [of minimal reserves] shifted to a robust reserves environment accompanied by new tools to help the Fed control short-term interest rates. In early 2019, the Fed stated that its intention was to continue to implement monetary policy under an architecture in which an ample supply of reserves ensures that control over the Fed Funds Rate is exercised mainly through the setting of the Feds administered rates, and in which active management of the supply of reserves is not necessary. Yet when the Fed ceased its QE asset purchase program in 2014, the supply of excess reserves in the banking system began to fall. And when the Fed began shrinking its balance sheet in 2017, reserve levels fell at an accelerated pace.

This was a concern to many Economists, including undoubtably those working at the Fed itself. The Fed did not know exactly what level of minimum reserves would be considered "robust" and surveys conducted over the past 24 months suggested that reserves wouldn't growth "scarce" until they fell below a level of $1.2 trillion. But the Fed had no way to control the desire on the part of banks to hold more reserves than necessary. In other words, banks were unwilling to lend their own reserves into repo markets, where many with US Treasuries wanted access to the reserves and the cash flows they represented by putting up their Treasuries stock piles as collateral. Once demand overpowered supply, the result was inevitable: repo rates spiked higher. The Fed concluded that perhaps it allowed its balance sheet to shrink too quickly and announced plans to buy roughly $60 Billion in short-term Treasury securities per month for at least 6-months and again this would function to raise the level of reserves in the financial system. Naturally, to many economists and investors, this is controversial because it looks an awful lot like QE principally because the two actions both have the affect of expanding the Fed's balance sheet.

However, the Fed's latest campaign of bond buying is distinct from quantitative easing in two ways: 1. QE was centered on a reduction in longer-term interest rates that encouraged borrowing for things like homes and risk taking that encouraged investors to buy more stock while repo operations conducted more recently have been affected purely to increase liquidity in the financial system and 2. QE had a signaling affect that was dovetailed by forward guidance – direct interviews or press

conferences with the Chair of the Federal Reserve…repo operations occurred without the added support of Fed commentary or guidance and in some ways are viewed as being more programmatic than subjective.

But many within the Fed including Vice Chair Richard Clarida suggest that the Fed wants to distance itself from liquidity intervention over time. Though it remains to be seen whether this can be done. A growing US Federal budget deficit contributes to challenges in the repo market rather than solving them.



[When Government runs out of money, which is often, they borrow. Borrow…by issuing Treasury securities…and quite a lot of them.]

With budget deficits under President Trump having increased significantly the supply of new Treasuries that the debt market is required to absorb has grown. Since the increases in deficits are not the result of counter cyclical policies but rather purported pro-growth policies investors are likely to experience continued ample supplies of Treasuries hitting the market. And that means the "average" buyer of Treasuries has changed from the Fed itself [again under its "QE" programs] or US multinationals with large offshore cash holdings. These days, more and more Treasury securities are being bought by primary dealers, the small elite group of banks authorized to do business directly with the Fed itself. The shift in buyer composition if you will suggests that more Treasuries will need to be financed rather than bought outright.

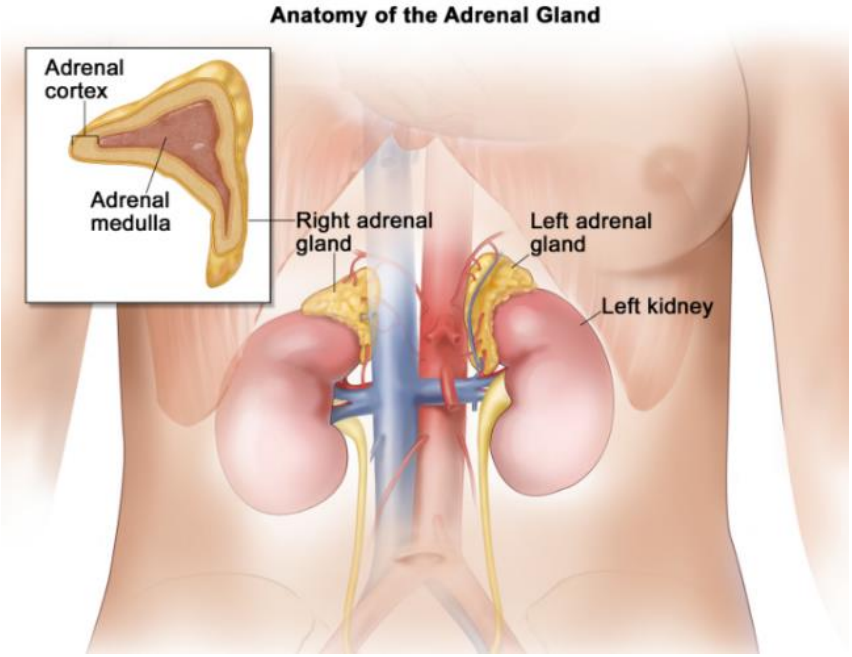
Which brings me back to 1984's Repo Man…

Of course, the use of the term "repo" in the context of a 1980's movie about vehicle repossession is very different from the application of the term to the US financial system. But the point is largely the same: sooner or later it will be time to pay up no matter which account it is coming from.

The MacNicol Investment Team

Behavioural Investing
The Adrenal Gland, your friend *or foe* in turbulent markets…

A week ago, a colleague of mine asked me if I knew that the same hormone that contributes to fear is the same hormone that contributes to our desire to fight and frankly this one was a piece of cake for me. Even the average University of Toronto graduate is likely to be pretty strong in endocrinology, which makes complete sense given that insulin was discovered there 99 years ago. In my own case, I completed three full endocrinology courses and befriended a very laid back Duck named Charlie. Officially, Charlie was a University of Toronto staff member [though not a Faculty member] and his role was to assist one my Professors during experiments. Charlie was well treated by the U of T and the experiments went a long way towards expanding my knowledge of how our hormone systems work. They also came in very handy during my own run in with the health care system back in August of 2017. In other words, yes, I certainly know that adrenalin is the "fight or flight" hormone and I even know where it comes from.



[The Adrenal glands sit on top of our kidneys and release the hormone adrenalin into our blood stream.]

Adrenalin's role in human history probably cannot be overstated. Just think about how crucially important it would have been for early humans to know whether an animal they were hunting, was worth the risk. But grasping adrenalin's role in investing is something that fewer of us might appreciate. Last month's market malaise did not truly feel like the present-day equivalent of Lehman Brothers imploding to me, but you would be forgiven for thinking it was. You would be forgiven for thinking that way because, quite frankly, you may not have had a choice.

Adrenaline helps your body react more quickly. It makes the heart beat faster, increases blood flow to the brain and muscles, and stimulates the body to make sugar to use for fuel. Unfortunately, common **adverse** reactions to adrenalin include

anxiety, apprehensiveness, restlessness, tremor, weakness, dizziness, sweating, palpitations, pallor, nausea and vomiting, headache, and respiratory difficulties.

[A lot of my friends who are not interested in financial markets think that sound investment advice comes from a complex spreadsheet or fancy computer model. The reality however is that sound investment advise comes from one of these.]

I suppose it is perfectly normal to feel apprehensive about something as important as one's savings. But you don't have to. At MacNicol & Associates Asset Management our mandate is to safeguard client capital first, so you don't have to feel anxious about your investments after a market induced spike in your own adrenaline levels. What's more, we take the time to talk to our clients whenever they need an independent perspective on markets or just someone to exchange ideas with. Sometimes talking things out [i.e communicating] can make the difference between allowing adrenalin to influence a poor investment decision made in great hast and staying focused on long-term financial goals.

[Dark clouds can storm even the most optimistic of market environments, the affect can leave you frightened and vulnerable to making a hasty (not to mention costly) investment decision. At MacNicol & Associates we aren't Endocrinologists, but we know a thing or two about behavioral investing, which can make us an effective antidote in turbulent times.]

But what about the "fight" response?

Adrenaline can fuel aggression too, and this can lead to accepting more risk than you originally felt comfortable with. Just because a stock has fallen doesn't mean the coast is clear. So, while we cannot control markets - nor how you feel about them as investors – we can control our actions just by having a quick call. Knowing that our process works well when markets don't and knowing that our firm is geared towards you might just be the antidote to your next adrenalin rush.

The MacNicol Investment Team

Firm News

The MacNicol Investment Team would like to congratulate 11-year old Canadian swimmer **Matthew Blackwell**. Matthew is with the Orangeville Otters swim team who competed at the Ontario short-course aquatic championships in Windsor recently. Matthew competed in 6 events, medalled in all of them and earned gold in the 200-meter Butterfly along with the 3rd fastest time ever for an 11-year old. Well done Matthew!

David and Diane MacNicol just returned from a holiday down south in the Caribbean. They visited their oldest son who is going to medical school on Saba Island. For those of you who have never heard of this island (most people have not!), it is a Dutch island near St. Maarten. It is a beautiful, steep and lush island. Besides the school, the main reason people visit is for the diving and the hiking. We hiked for 2 days and found it both very challenging and absolutely beautiful. The views were spectacular. It was a wonderful, relaxing trip!

After coming back in January from maternity leave, my transition back to work was smooth. Having Layla go to nursery school a few times a week has allowed for some time to be part of ongoing business initiatives as well as continue to service our clients. It's been a huge shift in my house to juggle three little humans but, it's also been very rewarding seeing the kids grow and enjoy the new addition to our family- the boys absolutely adore their little sister. **Naima Egal**

Statement from the MacNicol Investment Team on recent volatility in Financial Markets

As a result of recent volatility in financial markets, the MacNicol Investment Team would like to advise investors of the following. We are well positioned with:

- Well below market exposure to Energy
- Well above market exposure to physical Gold, Silver and Platinum AND Precious Metal Mining companies
- Cash
- Alternative Assets that tend to run counter to market declines
- Private Real Estate in growing demographic markets
- Public Market sales will find their way into Private Equity funds
- The MacNicol Alternative Asset Trust does not investment in oil and gas exploration or production companies or companies related to the exploration and production of oil or gas.

MacNicol & Associates Asset Management Inc.

Appendix A: The Federal Funds Rate and the Effective Federal Funds Rate

The Federal Funds Rate is the interest rate at which depository institutions trade Federal Funds (balances held at Federal Reserve Banks) with each other overnight. When a depository institution has surplus reserves account, it lends to other banks in need of increasing their reserves. More bluntly, a bank with excess cash, which is often referred to as liquidity, will lend to another bank that needs to quickly raise liquidity. The rate that the borrowing institution pays to the lending institution is determined between the two banks; the weighted average rate for all of these types of negotiations is called the effective Federal Funds Rate. The effective Federal Funds Rate is essentially determined by the market but is influenced by the Federal Reserve through open market operations to reach the Federal Funds Rate target.

The Federal Open Market Committee (FOMC) meets eight times a year to determine the Federal Funds Target Rate. As previously stated, this rate influences the effective Federal Funds Rate through open market operations or by buying and selling of government bonds (government debt). (2) More specifically, the Federal Reserve decreases liquidity by selling government bonds, thereby raising the Federal Funds Rate because banks have less liquidity to trade with other banks. Similarly, the Federal Reserve can increase liquidity by buying government bonds, decreasing the Federal Funds Rate because banks have excess liquidity for trade. Whether the Federal Reserve wants to buy or sell bonds depends on the state of the economy. If the FOMC believes the economy is growing too fast and inflation pressures are inconsistent with the dual mandate of the Federal Reserve, the Committee may set a higher Federal Funds Rate target to temper economic activity. In the opposing scenario, the FOMC may set a lower Federal Funds Rate target to spur greater economic activity. Therefore, the FOMC must observe the current state of the economy to determine the best course of monetary policy that will maximize economic growth while adhering to the dual mandate set forth by Congress. In making its monetary policy decisions, the FOMC considers a wealth of economic data, such as: trends in prices and wages, employment, consumer spending and income, business investments, and foreign exchange markets.