October 2020

The Quarterly

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 marketplace.

"It is the supreme art of a Teacher to awaken joy in creative expression and knowledge".

- Albert Einstein

The Numbers:

Index:	**Year-to-Date:**
S&P/TSX:	-5.5%
NASDAQ:	24.5%
Dow Jones:	-2.7%
S&P500:	4.1%

Interest Rates:	**Canada**	**USA**
90-Day T-Bill: 0.09%	0.12%	0.09%
5-Year Bond: 0.28%	0.36%	0.28%
10-Year Bond: 0.71%	0.57%	0.71%
30-Year Bond: 1.50%	1.12%	1.50%

Economic Data:

- Global equities were mainly higher during the 2nd quarter with only British and French stocks falling
- Large cap US technology stocks continue to set the pace with semiconductor stocks also higher
- WTI ends the quarter slightly higher at US $40 per barrel but still off over 30% for 2020
- Natural Gas prices ignited in the 2nd quarter with Henry Hub US contracts higher by 44%
- Industrial metals (primarily Cobalt) and precious metals (primarily Silver) posted double digit percentage gains in Q2
- Lumber prices sharply higher in Q2 up over 40%

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	29	22
P/B: Price-to-Book	3.8	3.3
P/S: Price-to-Sales	2.4	2.1
Yield: Dividend Yield	1.8%	1.9%

Year-to-date Performance, by Sector: September 30th, 2020

S&P/TSX Composite	- 5.5%
NASDAQ	24.5%
Dow Jones Industrials	- 2.7%
S&P 500	4.1%
Russel 2000 (Small Caps)	- 9.6%
MSCI EAFE	- 23.4%
Crude Oil Spot (WTI)	- 8.9%
Gold Bullion ($US/Troy Ounce)	24.9%
SOX Semi-conductor Index	23.0%
VIX Volatility Index	68%

Source: Canaccord Genuity Capital Markets & Thomson Reuters

Source: Jeffrey Saut, Raymond James

Foreign Exchange - FX

We continue to survey all the Banks and some Custodians to compare Foreign Exchange Rates charged. Since last quarter, we can see that rates have stabilized. 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 October 9, 2020 10:00 AM	$5,000	Cdn		
Banks	**Rate**	**Buy USD**	**Cost**	**% Difference from Spot Rate**
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.3152	$3,802	$(0)	0.0%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.3278	$3,766	$(36)	-1.0%
Raymond James	1.3325	$3,752	$(50)	-1.3%
Royal Bank	1.3411	$3,728	$(74)	-2.0%
Scotia	1.3473	$3,711	$(91)	-2.4%
TD	1.3500	$3,704	$(98)	-2.7%
Canadian Snowbird	1.3408	$3,729	$(73)	-2.0%
Spot Rate	1.3151	$3,802	$ -	0.0%

Bored boards, fickle investors…

There is an old expression in real estate that has been around for a long time. It goes a little something like this: "a 2x4 doesn't care whether it goes into a shack or a mansion". Given the run up in lumber prices this year it seems many care an awful lot about 2x4s…

If you glanced at the economic data portion of this edition of ***The Quarterly***, you might have noticed that one of the very best performing asset classes this year has indeed been lumber. Even when factoring in a brief clear cutting in September lumber prices have experienced a sizable growth spurt in 2020. At one-point (August) lumber prices reached a giant sequoia sized price of over $800. A smoother perspective requires some sanding: $350 to $450 is the longer-term moving average for North American lumber prices over the past decade or so.

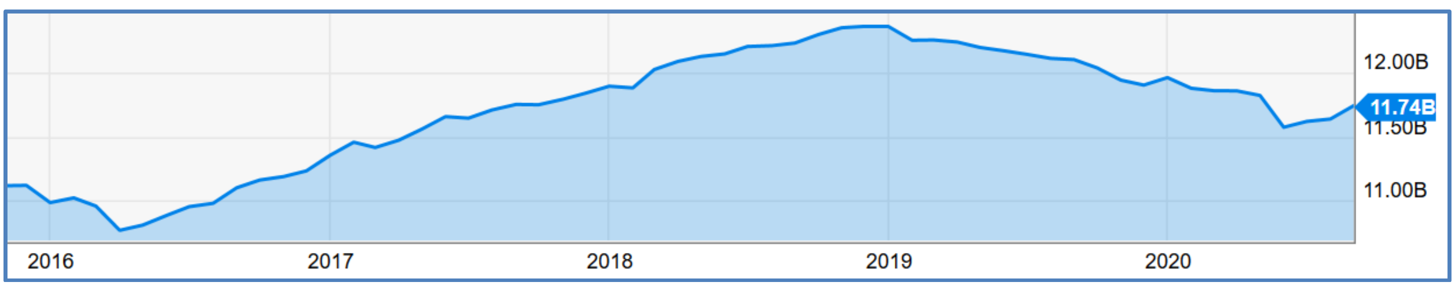
But periodic splinters can and do happen. In June of 2018, lumber prices made headlines when prices reached the $580 level. David MacNicol and I were in New York on business then and save for commodity traders, arborists and contractors, rising lumber prices weren't exactly the talk of the town. One factor that of course distorts lumber prices is tax. Canadian lumber imported into the United States has an import duty applied to it and has for years. I am 43 and recall the Canadian/US lumber debate has been going back and forth for my entire working career, which is to say 20 years. The basic idea is that Canadians are "dumping" government subsidized lumber into US markets causing enormous harm to American mills and producers. The US response has been a countervailing duty: a tax that functions to offset (Canadian) government subsidies and add a penalty on top of that to reassure us that Uncle Sam means business. The countervailing duty itself is a hot button issue for those in the lumber industry and for good reason. The World Trade Organization (WTO) recently issued a panel report on US duties applied to Canadian lumber in which it found US duties to be (surprise, surprise) "inconsistent with international trade rules". Washington disagrees with the WTO and has filed an appeal just this past September. Canada's International Trade Minister was quoted as saying:

> *"U.S. duties on Canadian softwood lumber have time and again been found to be unfair and unwarranted. These duties have caused unjustified harm to Canadian industry and U.S. consumers alike and are impeding economic recovery on both sides of the border."*

- Mary Ng, Canada's International Trade Minister

What else would you expect a politician to say?

Duties are certainly a factor in lumber pricing but then they always have been. The MacNicol Investment Team feels the bigger issue towering over lumber prices today is the simple interplay between supply and demand. US lumber inventories began 2020 well off their 2019 highs and COVID 19 mill closures, restrictions on cross border shipping and a "boom" in both do-it-yourself projects and professional renovations has made the situation that much worse.



[US Lumber inventories peaked in January of 2019 but is recent lumber demand as strong as a Californian Redwood or more fragile like the plywood used to make your Ikea shelving unit?]

In my own neighborhood in Toronto's east-end, I have lost count of the number of contracting vehicles or trades personnel parked out front of many of my neighbor's homes. The resulting activity has my little hamlet looking nicer overall but not before a thorough power washing. Beneficiaries from this activity include not just manufacturers of power washers. Shares of Home Depot [NYSE: HD] and Lowes [NYSE: LOW] are outperforming the TSX, Dow Jones and S&P500 mainly due to very solid Q2, 2020 earnings. Executives at both firms attribute second quarter performance to a consumer who is spending more money on their home than away from their home. We would not touch Home Depot or Lowes with a 10-foot pole, not now anyways. Wood shortages have also compounded the affordability woes associated with new homes: the rising cost of framing lumber has meant that new homes cost thousands more. So, we are likely to take a pass on home builder stocks also.

Our alternative platform, on the other hand, does invest in home building and the lands on which future homes are to be built. In 2019, partners of ours in Florida sold single family homes (quite a few of them) to DR Horton [NYSE: DHI] and we expect that trend to continue. As far as the here and now, our view is that lumber prices have likely bloomed and at this point are poised for a cut, which leaves us asking a question: if the share price of a lumber stock or home builder falls in a market with no investors to hear it does it actually make a noise?

The MacNicol Investment Team

The long term…a series of short terms…

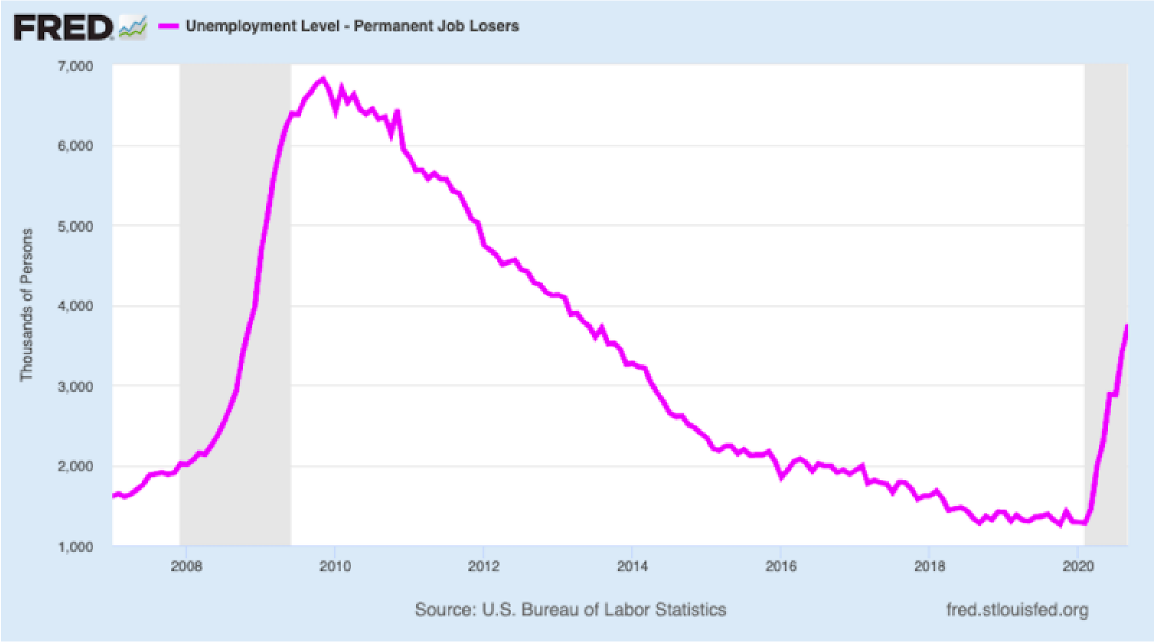
Prior to US President Donald Trump and First Lady Melania Trump testing positive for COVID 19 the single biggest news story in financial markets was the dreaded "2nd wave" that everyone anticipated would happen. Like clockwork COVID cases are sharply higher, particularly in Ontario, and experts are modelling that thing get worse before they get better. While the majority of new COVID cases are in people under the age of 40, the concern is that this group will unintentionally infect older (and more vulnerable) cohorts. So, this is certainly not the time to let one's guard down.

[If Ontario Premier Doug Ford looked worried to you in this press conference held just 5 days ago, he should be. Ontario is careening towards the dubious 1,000 new COVID cases per day mark.]

COVID 19 has of course had a severe social, economic and human toll and even though COVID "fatigue" is beginning to surface the virus remains a formidable pathogen that should not be taken lightly. But another ailment that should not be taken lightly is temporary job losses that eventually become permanent. Back in April, when lockdown related job losses began, my colleagues and I were floored by the weekly reports of first-time unemployment filings on both sides of the border. In the United States, such figures are usually released just prior to our own internal research meeting. I specifically recall an Analyst friend of mine texting me the morning of one such release…

"Thank goodness, only 3 <u>million</u> this week".

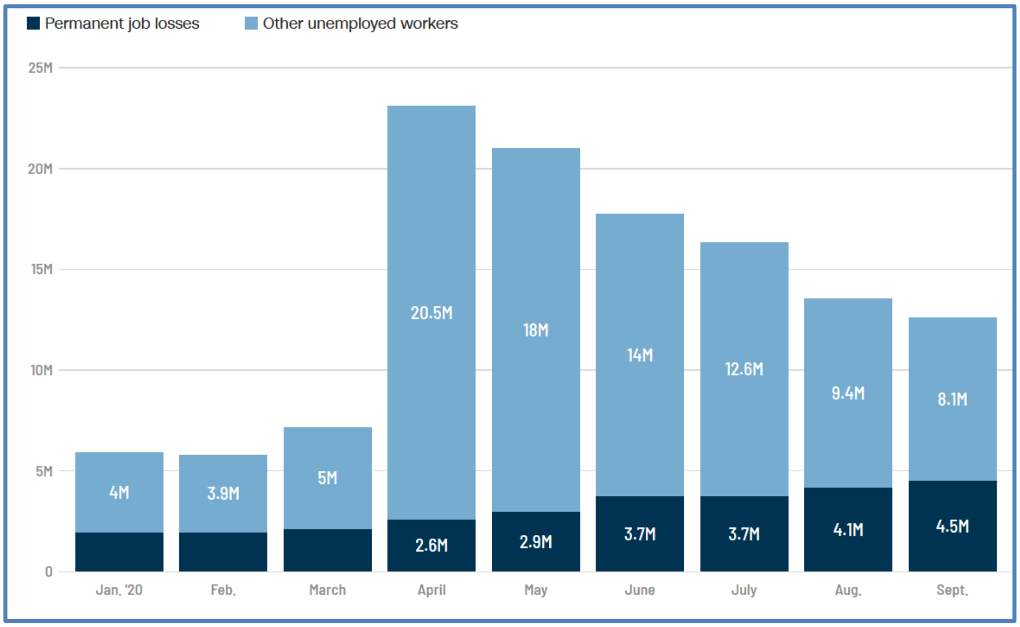
It was really hard to grasp that in a matter of weeks, the US unemployment rate, once the envy of the world, and a key argument as to why the US consumer debt "problem" wasn't really a debt problem, was turned on its head. One thing that helped sooth our concerns though was economic reports which assured us that most jobs lost during lockdowns would return once businesses could re-open. In theory it made perfect sense. Unfortunately, many businesses remain closed and many have gone bankrupt. This has led to more workers struggling to find employment options while facing the grim reality of being allocated to a group identified as the permanently unemployed.



[COVID 19 lockdowns resulted in what economists termed "transient" or "temporary" job losses. Though millions of workers have returned to their roles, the more recent 8% US unemployment rate masks a growing, and grim, reality, which is that for many, they are never going back to their old jobs.]

For many, picking up occasional part-time jobs or transitioning fully to the "gig economy" has afforded them some relief. But the number of unemployed who are out of work due to the end of temporary jobs has also been rising rapidly over the last seven months. Many of those workers were used to moving from one job to another have now not been able to find the next job as normal.

The human toll of lives lost to COVID 19 is of course a much crueler reality to come to terms with. But the cold, hard reality that millions of jobs have potentially vanished for good is a painful reminder that economic carnage can exact a severe toll too. Indeed, the latest reports from the Bureau of Labour statistics suggests that the labour market recovery is rapidly losing steam. Low hanging fruit have already been picked and for many (millions) the time to truly hunker down is at hand. A severe ripple effect could see people simply stop spending money if they are behind on credit card payments, automotive leases or mortgage payments. Hopefully, governmental officials will act soon, yet there is no new deal. As helpful unemployment insurance benefits roll off, the plight of the unemployed will become more widespread, and penetrating.



[The US Department of Labour tracks temporary and permanent job losses. The darker, navy blue bars, present a worrying series of short-term problems for the labour market that may result in a longer-term threat to consumption.]

As of September, the U.S. labor force had about 142 million workers, down 7% from pre-pandemic levels. But employment in leisure and hospitality is 23% below pre-pandemic levels, more than any other industry. Temporary furloughs are becoming permanent layoffs as companies that had hoped to reopen fully make tough choices. Walt Disney Co. announced last month it will cut 28,000 jobs. United Airlines and American Airlines will furlough 32,000 workers. Cineworld, the world's second-largest cinema chain, will cut approximately 20,000 U.S. jobs. The number of people who had been out of work for at least 27 weeks increased by 781,000 in September to 2.4 million, according to the Labor Department. Another 345,000 people were permanently laid off that month, increasing the total to 3.8 million. Some economists are concerned the pandemic has set off a long-term shift reminiscent of the 2008 financial crisis. Cost-cutting and technological improvements contributed to a drop in office, administrative, manufacturing and construction jobs, which never returned.

Education and training are for many the only hope, but that takes time, money, and a realization that the average 45-year-old simply does not have the cognitive stamina that a 25-year-old has. For many, the clock is ticking and even if a new government stimulus plan is enacted, it may not be enough to stem the tide of those destined for the ranks of the permanently unemployed. As with so many other aspects of life, COVID did not cause the economic realities that today lie before us, it simply accentuated pre-existing conditions.

The MacNicol Investment Team

Behavioural Investing

Focus: less allocation, more filtration…

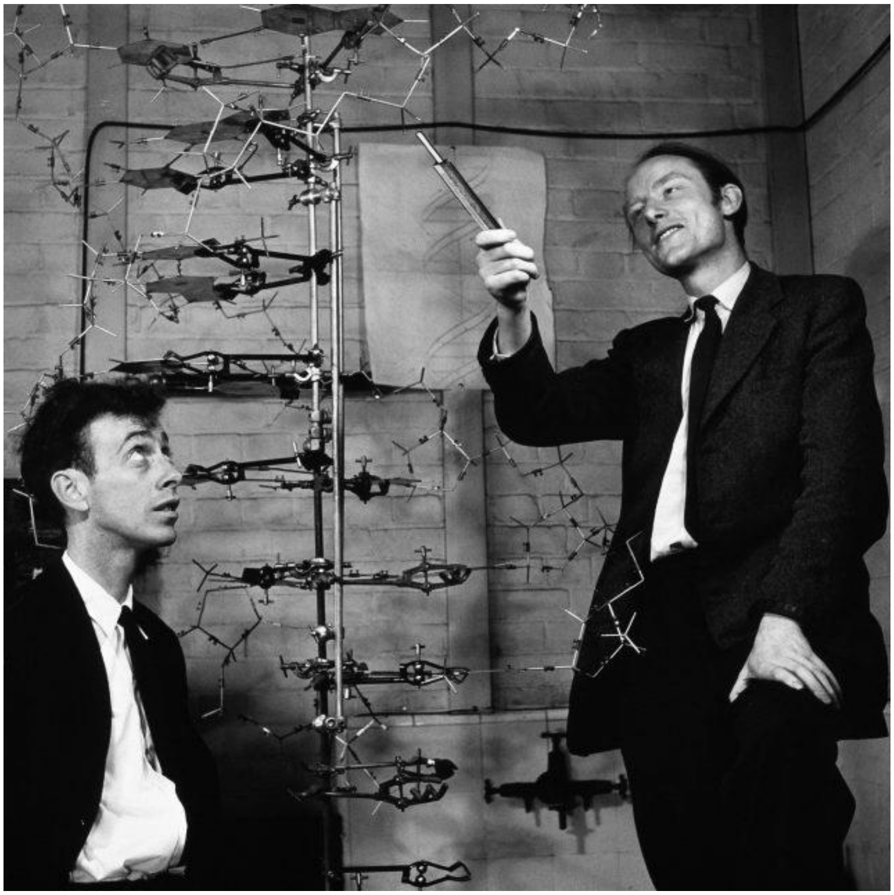
For years, when it came to the topic of mental focus, the view from the medical community was that a region of our brain known as the cerebral cortex simply allocated more cognitive processing power to a single data point or thing. Think of a hungry Eagle looking down into a Lake from high above during the avian variant of lunch hour: the Eagle's stomach is growling, cross winds are blowing, other hungry Eagles are hunting, and several prospective fish ("menu options") lie down below - many of which might be quite quick. In other words, our Eagle must face many distractions prior to getting to eat his lunch. Whether or not lunch gets served at all had for years been understood as a function of the Eagle's ability to harness maximal processing power to isolate (focus) on the one fish he was most likely to catch.

["C'mon on brain…allocate, allocate!]

But a significant departure from this line of thinking came in 1984 when Francis Crick suggested that the brain's ability to focus had less to do with allocation and more to do with filtration.

Filtration?

Crick surmised that a region of the brain called the **thalamus** may act as a sort of informational gatekeeper, controlling the level of information passed along to the cortex and ostensibly blocking out the "noise". Crick's hypothesis thus was that overall processing power was *related to* one's ability to focus but not the whole story. Sadly, Professor Crick died in 2004 but not before cementing his legacy as a giant in the world of molecular biology…



[Francis Crick, the man pointing, was a giant in the world of molecular biology. Together with his partner, James Watson, the man observing from the left, Crick was awarded a Nobel Prize for contributions to our understanding of the structure of nucleic acids and their significance on the flow of information in living systems. Though several of the fundamental underpinnings of the DNA structure were based on work conducted by Rosalind Franklin, Raymond Gosling and Maurice Wilkins, Crick is widely credited with biology's "central dogma", which states that once genetic information is transcribed from nucleic acids to proteins it can never be reversed.]

In the years since Professor Crick passed, the important work of mental filtration continued. Leading the charge was Professor Michael Halasaa of MITs McGovern Institute of Neuroscience. In a 2015 paper, Professor Halassa and his colleagues explored how attention can be consciously pivoted between different kinds of sensory inputs. In coaching laboratory rats to switch their focus between a visual and auditory cue, Halassa found that while undertaking the switch the rats suppressed the competing sensory input, allowing them to focus on the hint that earned them a higher value reward, I assume organic peanut butter or cheese. The process appeared to originate in the prefrontal cortex (PFC), which is critical for complex cognitive behavior such as planning and decision making however researchers also found that a part of the thalamus that processes vision was inhibited when the animals were focusing on sound cues by a region known as the basal ganglia. Crick (and Halassa's) research expands our understanding about how we focus. Processing power is indeed important, but so is the ability to eliminate distraction.

I would not frame the MacNicol Investment Team as a "filter". As a matter of fact, we always tell clients what we really think. Yet after 19 years one of the ways in which we have helped investors the most is by eliminating the often-distracting noise that frustrates many investment decisions. With the noise gone, it become a lot easier to focus on what is important to your investments, your bottom line, and your financial future.

Now enjoy your lunch…

The MacNicol Investment Team

Firm News

We are excited to announce that the MacNicol Alternative Asset program turned 10 on October 6th, 2020.

We are pleased to announce that Karan Ramlochan has joined the MacNicol team in the role of Portfolio Administrator. Karan recently graduated from the Ted Rogers School of Management at Ryerson University with a Bachelor of Commerce degree. As well as helping with the operations and back office work, Karan will focus on the marketing efforts for the company.

On Friday, September 25th, David MacNicol participated as one of The Yellow Bus Foundation's (YBF) 41 participants in its 2020 Golf Marathon. YBF's 2020 Golf Marathoners & Supporters raised an incredible $591,700!

The Yellow Bus Foundation is pleased to present the 2020 Golf Marathon Video! Please **click here** to watch now.

MacNicol & Associates Asset Management Inc.
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