August 2021

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 marketplace.

"In the long dusks of Summer, we walked the suburban streets through scents of maple and cut grass, waiting for something to happen."

-

Steven Millhauser, *Dangerous Laughter*

The Numbers:

Index:		**2021 YTD:**
S&P/TSX:		16.8%
NASDAQ:		14.5%
Dow Jones:		14.7%
S&P500:		17.8%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	0.17%	0.05%
5-Year Bond:	0.78%	0.86%
10-Year Bond:	1.12%	1.18%
30-Year Bond:	1.70%	1.83%

Economic Data:

* ADP reports that private sector employers added back just 330k jobs in July versus estimates of 690k
* Crude oil more volatile in July on fluctuations between $66 and $75
* Lumber off 23% in July at $606.50/bft
* Stocks mainly mixed in July with developed market Blue Chip indices outperforming small caps and emerging market stocks
* BITCOIN up 14% in the month returning to flat

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	34	34
P/B: Price-to-Book	4.7	3.5
P/S: Price-to-Sales	3.2	2.3
Yield: Dividend Yield	1.3%	1.9%

2021 Calendar Year Performance, by Sector: Aug 3rd, 2021

S&P/TSX Composite	16.8%
NASDAQ	14.5%
Dow Jones Industrials	14.7%
S&P 500	17.8%
Crude Oil Spot (WTI)	46.4%
Gold Bullion ($US/Troy Ounce)	-5.0%
SOX Semi-conductor Index	22.7%
VIX Volatility Index	-19.3%

Source: Canaccord Genuity Capital Markets and Thomson

Foreign Exchange - FX

As of Aug 9, 2021 11:00 AM	$	5,000	Cdn		
Banks	Rate		**Buy USD**	**Cost**	**% Difference from Spot Rate**
CIBC	No Public Rate Posted Online				
Interactive Brokers		1.2573	$ 3,977	$ (2)	-0.1%
Laurentian Bank	No Public Rate Posted Online				
National Bank		1.2704	$ 3,936	$ (43)	-1.1%
Raymond James		1.2690	$ 3,940	$ (39)	-1.0%
Royal Bank		1.2824	$ 3,899	$ (80)	-2.1%
Scotia		1.2885	$ 3,880	$ (99)	-2.5%
TD		1.2922	$ 3,869	$ (110)	-2.8%
Canadian Snowbird		1.2676	$ 3,944	$ (35)	-0.9%
Spot Rate		1.2566	$ 3,979	$ -	0.0%

The greasy answer to a $1.5 million question…

I am not a big fan of greasy food. Sure, it tastes great, but it makes me feel sick the next day and I swear the stuff even exerts an adverse psychological impact on me. So in general, I try to eat pretty well. Over business lunches [back when those were still happening] my colleagues would say things "*How can a guy your size get full on that*" or "*Joe, I'd swear you were a Rabbit*", and that's due to my preference for, vegetables. I have my own reasons for eating healthy [or trying to] and the motivations span a pretty broad range. For example, my *economic* rationale for eating like a bunny boils down to cost and storage space. In the past few years, I have had a fellow down the street make my work-related dress shirts. They are very nice, but cost more than off-the-rack models and when coupled with my smaller Toronto house, purchasing dozens of these things isn't an option. The economics really kick in whenever I am reminded that custom made dress shirts come with the promise of looking great, but only if you do not gain a single pound…

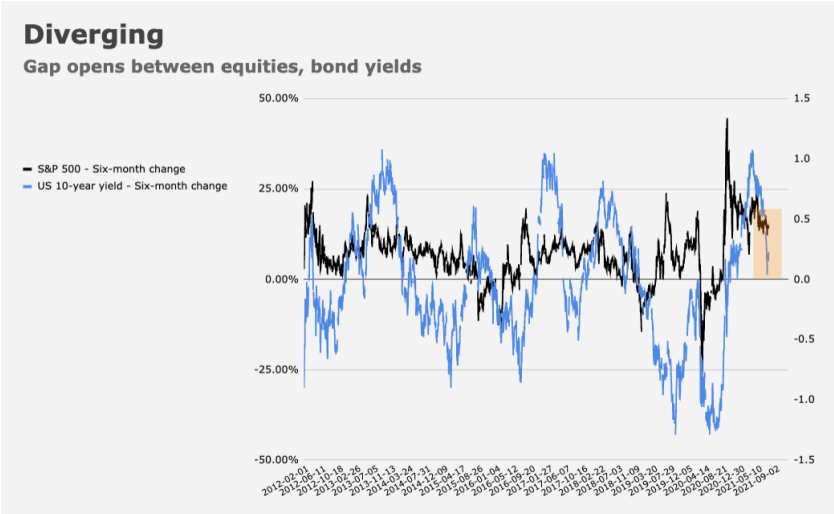
That said, I did happen to pull over at a Chip Truck on my ride up to a cottage I stayed at last week. I have passed this Chip Truck before and given the preparing for the cottage is somewhat time-consuming cooking wasn't in the cards for me that day.

Pulled Pork Sandwich…

Of the greasy pleasures I occasionally indulge in, I am something of a sucker for pulled pork sandwiches. So, I placed my order and waited. Now while my sandwich was being slopped together, two younger boys in their 30s got their turn to place their orders and proceeded to order just about everything on the menu. I really don't think these two fellows were malnourished. Both were certainly what you might call "full sized" adults. Trust me, I wasn't judging. However, their indiscriminate dabbling in deep-fried debauchery made me think an awful lot about the stock market, and my sister-in-law Stacey. Stacey just closed on the sale of her home in Toronto. After years of dreaming for a house in the country, the decision to leave the GTA was made with Stacey's home in Toronto's east end hitting the market. It was a really nice home, and it sold quickly. So quickly in fact that Stacey had not yet found a new home, resulting in a condition I term as a "homeless millionaire". Of course, Stacey is not actually homeless and currently rents a spot not far from where her old house is. But now Stacey faces a problem that she might not have bargained for, which is that she has over a million dollars in her bank account that she really doesn't know what to do with. Finding a new home in the country could take a year…heck finding the *perfect* new home in the country could take a couple of years. Renting in Toronto is far from free, yet you also want ample liquidity on hand for when find your dream home. So, do you avoid putting all or just some of that money to work?

"Homeless" millionaire…

Stock valuations are higher [see *The Numbers* on page 1] and the expected returns on equities are more range bound over the Summer. Without a strong catalyst for growth corrections at some point in the fourth quarter look like a reasonable bet. Another thing I often wonder is the extent to which stocks are being propped up by loose monetary policy.



[The bond market is signaling that economic activity is turning lower after having recovered from last year's COVID crunch.]

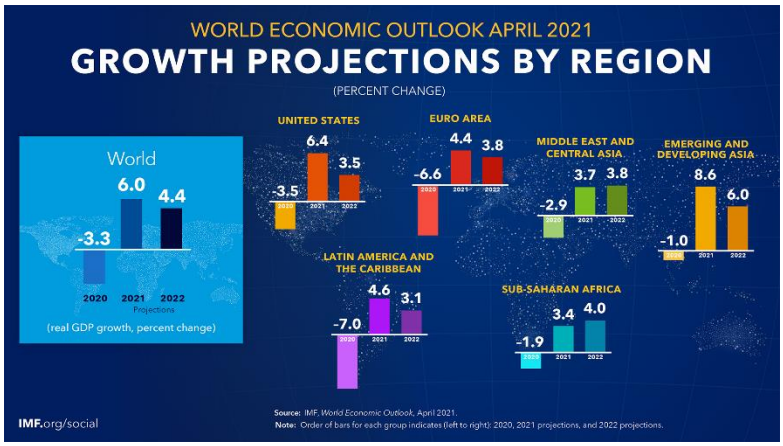
You may enjoy greasy food too, but I doubt you have much appetite for rosy sell-side analyst calls, their evolution over the course of the pandemic and recovery, or new fandangled investment opportunities. One particularly frustrating issue involves the tension between predicting gains for financial assets and a macro backdrop defined by widespread economic destruction in 2020 and an uneven economic recovery in 2021 to date. A lot of businesses are gone for good, lost over time lockdowns vaporized investment and caused so much economic hardship for so many. Of course, nothing is more damaging than the lives lost. But there is something that lack delicacy when it comes to making rosy projections for stocks or the economy. We are not dour on investing here at MacNicol & Associates Asset Management. But ordering everything on the menu isn't our style…not now or ever. If the global financial crisis was an exercise in looking for financial innovation in the smoldering ashes of that wreck, the key to capitalizing on the pandemic was predicting that the extent to which the situation would provoke a decisive policy response, involving not only cheap money for financial markets, but a fiscal push designed to better stimulate a more sustainable economic resurgence. Replacing entire income streams for whole populations cannot be done by mailing out cheques or placing a moratorium on evictions for a period of time. Better access to education and training programs were a noticeable omission in fiscal policy. Many people were stuck at home, what better time to retrain for a new career?

We believe the market is transitioning from a position of maximum monetary accommodation and growth to a situation in which the low hanging fruit have already been picked. Years including but not limited to 1994, 2004 and 2011 come to mind, and in those years and others like them equity markets were shaped by narrowing leadership [something we have discussed for well over a quarter at our weekly research meetings] declining valuations, a pivot towards quality and a reasonable chance of 20% pull backs in major developed world indices.

[The Price-to-Book value ratio compares a company's market value to its book value or net assets. In other words, if a company sold off all its assets and used the money to repay all its debts, the value left over would be the company's book value. What is noticeable in this graph is that the Price-to-Book value ratio for the S&P 500 is nearly as high as it was in the early 2000s, which means investors are placing an awful lot of value on a company's leftovers.]

Breadth is something we have also touched upon at our weekly research meetings. It's been deteriorating, quite a bit and was made worse when popular reflation trades recently erased YTD gains [just look at shares of Delta Airlines] and the bond market rallied in more of a stampede that flattened the curve. Much as fewer and fewer citizens are participating in the recovery, fewer and fewer stocks are too. What's missing, though, is an index-level drawdown.

True, that hasn't happened just yet but that is mostly related to strength is a very small handful of tech heavyweights, which have benefited from the bond rally, and concurrent worries about the growth outlook.



[The International Monetary Fund told us in April that real GDP for the world will be lower in 2022. We peg the odds of a further reduction in growth forecasts as a plausible and we think many investors will be prompted to examine their own personal investment outlooks as a result.]

In the end, I advised Stacey to be cautious and selective with her money. Being prudent stewards of investment capital is not only something we practice here at MAAM for our investors, but also something I believe in personally. As for the two boys at the Chip Truck, I never did get a chance to tell them to cool it with the "face stuffing". I'm not saying there is anything wrong with indulging a bit every now and again – but as in the stock market and as in other aspects of life, too much of anything is likely a bad thing.

The MacNicol Investment Team

Chinese companies, US stock exchanges…and who really is on drugs…

The first opium war [there were a couple] was caused by the Chinese seizing opium stocks in Canton [known more colloquially as Guangzhou – the "hub" of the Pearl River delta] and threatening to execute anyone caught participating in the opium trade. This of course infuriated the British who quite liked the opium trade or at least

their version of it.

Direct maritime trade between Europe and China began in or around 1557 when the Portuguese leased an outpost from the Chinese in Macau. Other Eurozone nations quickly followed to supplant one another in a game of intra-regional commerce with Arab, Japanese, and Indian merchants. Opium, as a medical ingredient, was documented in Chinese texts as early as the Tang Dynasty, but as more and more opium transitioned to "recreational" use, regulators stepped in. The first restriction on opium was placed by the Qing Dynasty in 1729 when a substance called Madak [the opium equivalent of a "blunt*"] was outlawed. Back then, Madak production used up a heck of a lot of opium being imported into China and the Brits realized they could reduce their trade deficit with China by importing [narcotic] opium into China from facilities they controlled in Bengal whilst maintaining the medicinal opium for themselves. Naturally, the Chinese didn't appreciate the societal dislocations created by a widening drug problem amongst their citizens and they certainly didn't appreciate the British making money by hooking more and more Chinese on drugs. And so, by the 1780s edicts [authoritative decrees issued by a King, Queen, or other sovereign of a country] banning opium started surfacing and were soon followed by laws, which meant you had no excuse.

[National humiliation at the hands of Imperialism drove the Opium Wars.]

*** A blunt is a cigar that has been hollowed out and filled with cannabis. It is rolled with the tobacco-leaf "wrap", usually from an inexpensive cigar. A blunt is different from a joint, which uses rolling papers.**

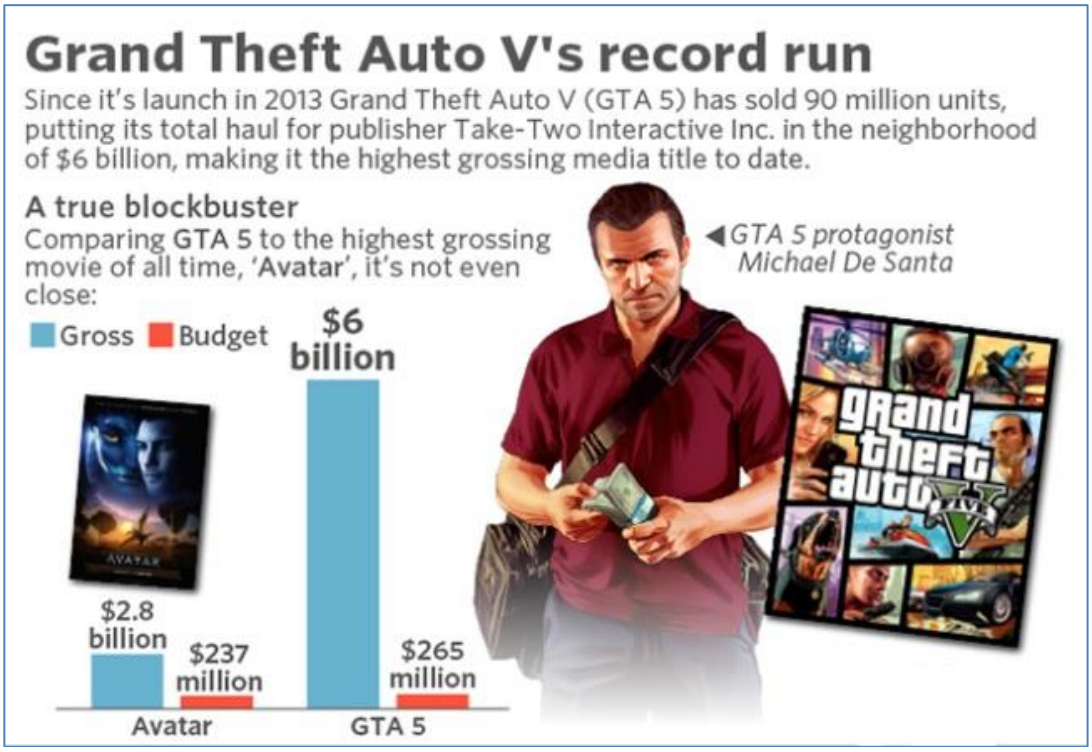
Speaking of edicts and laws…

It was another tumultuous week for one of the world's most widely followed internet stocks. Tencent crumpled worse than a junkie in rehab, plunging to a year low amid raucous regulatory restrictions from Beijing. Tencent is an internet company mainly focused on internet gaming.

[Tencent, is officially a Chinese multinational technology conglomerate holding company. Founded in 1998, its subsidiaries globally market various Internet-related services and products, including in entertainment, artificial intelligence, and other technology. Source: Yahoo Finance.]

So, what we have here my dear investors have been two things: the internet [a gateway] and gaming [a form of interactive entertainment or media]. I have seen this before. Not too long ago a little-known video game called Grand Theft Auto burst onto the scene glorifying a life of crime and violence. It was an overnight sensation…

[That's Grand Theft Auto 5's Michael DeSanta. Mike's not being rude Mike's looking ahead, because that's what successful people do. And when it comes to success, Grand Theft Auto 5 really is the grand pooh-bah of media. Note that I didn't say video games, I said media. Read on…]



[Yup, you guessed it. Since it's inception, globally, Grand Theft Auto 5 has gone on to become not only the most popular video game ever, but it's also life-to-date haul of around $6 billion makes movies like "Avatar" look fake. Imagine that a game, that glorifies a life of crime, is the top selling individual work media ever produced.]

Make no mistake, there were tons of drugs in Grand Theft Auto 5. There was an in-game advertisement in which the local member of congress was pushing to legalize…get this…**medical cocaine**. Yes, video games, and certainly the internet, *can be* used for evil. And that's what the Chinese Economic Information Daily [an uber right-wing state-run agency reckons is going on with Tencent]. The exact term used by the daily was "electronic drugs" akin to "spiritual opium," in a report calling for more regulation, including enhanced content review and unspecified "punishments", which let's face it could result in you being *shot* [rather than virtually shot as in Grand Theft Auto]. Now as I personally read some of the published reports on what is going with Tencent in preparation for this edition of ***The Monthly***, reports were circulating that some younger students currently spend eight hours a day playing "Honor of Kings," a popular Tencent title. And obviously that has caused Tencent to announce new limits on the amount of time minors can spend playing the company's online games. Oh yeah and in-game purchases by users under 12 will be banned, according to a statement on WeChat. The company also suggested the industry consider a total ban on children under 12 accessing online games.

Now here's the thing people don't really understand: the Chinese aren't pouring water on Tencent, they're pouring gas on Tencent, even as investors worry that China may extend its historic crackdown on the private sector to the gaming industry, Tencent's popularity is growing. What do you possibly think youngsters and teenagers alike will yearn for most? The answer is quite simply anything they cannot have that is represented to them by an authority figure as "bad". Sure, restrictions are there, but many parents aren't always keenly aware of the content their children are consuming, nor how much of it they ingest daily.

Thug life…

[At this point I'm sure you were thinking I was going to put a picture of one of the gangsters from Grand Theft Auto 5 here…you were mistaken…now hand over your wallet.]

The boss speaks, the industry responds…*immediately*. Autocracy, fear, and the sort crushing rule over freedom of expression are things that games like Grand Theft Auto and companies like Tencent flip a big middle finger to. Failing to appreciate that dynamic is why western investors continually find themselves aghast about happenings in the East. We just cannot fathom the idea that power can reside *outside* of capital and those societal imperatives might totally outweigh the market in the minds of a country's leadership. The problem is the Chinese fail to see the profit potential in Tencent in addition to the obvious profit potential that comes with less restrictive and more open markets. Tencent uses licensing deals to assist *foreign* game developers anxious to tap the Chinese market. If you thought being a Tencent investor was scary, can you imagine being a Vice President [or higher] at the company itself?

I'm going to need some of that "medicinal opium"…

I've heard of gaming addictions before. Kids couldn't put down Grand Theft Auto if you paid them, this despite that game's 17+ or what is called "mature" rating. And Super Mario brothers is something grown adults play today, that despite that game's age of over 30. But since Jack Ma threw Chinese regulators under the bus last October, Beijing has cracked down on mega-tech, ride-hailing, food delivery, education technology and now online gaming companies as though they were dropping off opium in the streets of Shanghai by the ton. And therein lies the real risk. Just about *any* business could be described as at least quasi related to a social necessity, a public good or some strategic goal. This isn't the first time Chinese state media has resorted to drug references to describe the perils of online games, nor is this the first sovereign nation to object to constructs that fall outside of norms itself righteously put in place, it won't be the last.

The MacNicol Investment Team is **not** currently a holder of Tencent shares for either the portfolios that we manage for private families or in any of our Alternative Asset Platform. But we will admit to logging in every now and again to check out the action from the sidelines. At some point, Tencent's valuation becomes too good to ignore, sparking a rally not only in shares of its own stock, but in shares of other tech giants that endured a Beijing beatdown. Believe me when I tell you this, Grand Theft Auto encountered the sort of political and regulatory scrutiny that would cripple most mainstream media outlets yet went on to become widely regarded as one of the very best video games ever made, but a rip roaringly runaway sales star.

At issue here is not the debate over whether young children should be playing video games at all hours of the day which infuse their impressionable minds with a world of crime, violence, or sleaze. Rather, at issue here is a fight over capital mobility and the belief in free market capitalism. Beijing, sadly, feels that it is being taking advantage of by a trade that travels through internet cables and fiber optic wires rather than ships, and that is too bad because they are doing it to themselves.

The MacNicol Investment Team

Behavioural Investing

Breath…

I think most people who know me would describe me as a confident person but no narcist. Yet one day, roughly 15 years ago, I recall looking into a mirror and being horrified:

"OMG a wrinkle". "OMG a grey hair". "OMG a *wrinkled grey hair*"

Does your mind often take in data points and immediately "jump" to the worst possible outcome? In psychology, worst-case scenario thinking has a name: catastrophizing. This cognitive distortion commandeers your mind to overestimate and exaggerate the probability of terrible things happening. Like all your worst fears and nightmares are always suddenly on the table as possible outcomes.

When it comes to one's finances, one can certainly be forgiven to being overly sensitive to things like dips in the stock market or the rising cost of things like food, fuel, and certain material goods. One thing we have learned over the nearly 20 years our firm has been in business [and the several decades more that our senior team members bring to the table] is that often, one of the best ways to tackle catastrophizing is by moving yourself to the center of the table.

[Our offices are open, and we closely follow all safety guidelines, so we would love to meet you especially if something doesn't feel right about your current portfolio. However, if you still haven't received your vaccine for dealing with City of Toronto traffic, that's fine. We are as wired up as we have ever been.]

Often, simply talking to us can make you feel better about your financial situation. Part of the comfort people feel when speaking to us is that we do not oblige you to hire us to manage your money on the spot. We will tell you what we really think about financial markets, the economy, and your current portfolio of holdings even if they are with another manager or bank. In many ways, the world continues to deal with the economic and societal fallout of COVID 19. But that doesn't mean you should ignore investing for the future. Recently the Ontario Teacher's Pension Plan announced that they were expanding [not reducing] their Alternative Asset exposure by tens of billions of dollars. Our own firm's well defined Alternative Asset Program receives its own publication, which you are welcome to check out through our website. But the point is this: one of the largest and most well-run pension plans in our country can deal with catastrophizing, we get that maybe you can't. Perhaps you are new to investing or simply do not like the idea of having to spend time studying financial markets and making allocation decisions. And that's where we can really help. If you think you or someone you know might benefit from our help and appreciate what we do, please give us a call at 1-866-367-3040 or visits us at www.macnicolasset.com

The MacNicol Investment Team

Firm News

Back to school in August! Naima is very excited about her two little boys going back to school in a face-to-face setting this year. Her boys were as excited as her as they geared up to attend 3rd grade and 1st grade on August 2nd. Going back to school gives Naima and her family some hope that things are starting to head in the right direction with the hope of getting back some type of normalcy.

MacNicol & Associates Asset Management Inc.