October 2021

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.

"Great minds discuss ideas; average minds discuss events; small minds discuss people"

- Eleanor Roosevelt

The Numbers:

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Index:		**2021 YTD:**
S&P/TSX:		15.1%
NASDAQ:		12.1%
Dow Jones:		10.6%
S&P500:		14.7.%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	0.15%	0.04%
5-Year Bond:	0.82%	0.82%
10-Year Bond:	1.24%	1.38%
30-Year Bond:	1.80%	1.98%

Economic Data:

- US dollar bottoms out in September on general Hawkish Fed sound bites
- Crude oil moves substantially in September to $78 per barrel
- Stocks globally lower in September with markets in Shanghai and Japan bucking the trend
- Gold lower at $1,757 per ounce during September but showing signs of a bottoming process developing

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	34	35
P/B: Price-to-Book	4.7	3.7
P/S: Price-to-Sales	3.1	2.5
Yield: Dividend Yield	1.3%	1.8%

2021 Calendar Year Performance: September 30th, 2021

S&P/TSX Composite	15.1%
NASDAQ	12.1%
Dow Jones Industrials	10.6%
S&P 500	14.7%
Russel 2000 (Small Caps)	15.3%
MSCI EAFE	5.6%
Crude Oil Spot (WTI)	56.6%
Gold Bullion ($US/Troy Ounce)	-7.9%
SOX Semi-conductor Index	16.5%
VIX Volatility Index	-67%

Source: Canaccord Genuity Capital Markets & Thomson Reuters

Foreign Exchange - FX

As of Oct 18, 2021 4:00 PM	$ 5,000	Cdn		
Banks	Rate	**Buy USD**	**Cost**	**% Difference from Spot Rate**
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.2378	$ 4,039	$ 0	0.0%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.2505	$ 3,998	$ (41)	-1.0%
Raymond James	1.2550	$ 3,984	$ (55)	-1.4%
Royal Bank	1.2664	$ 3,948	$ (91)	-2.3%
Scotia	1.2737	$ 3,926	$ (114)	-2.9%
TD	1.2738	$ 3,925	$ (114)	-2.9%
Canadian Snowbird	1.2705	$ 3,935	$ (104)	-2.6%
Spot Rate	1.2379	$ 4,039	$ -	0.0%

The 'Fewocious' world of Non-Fungible Tokens: more than just anime-inspired robots

It felt like a good time to write another article about the manic, but frankly misunderstood, topic of NFTs or **Non-Fungible Tokens**. What tipped me off about the timing for this write up was an e-mail from a client roughly a week ago. Here is the e-mail:

"Joe, I feel really good about this press release, but I have no idea what just happened"

What happened was that an early stage FinTech company specializing in digital economy everything had just unveiled its own NFT gallery and the feedback from consumers and investors ranged from "Gosh that's ground-breaking" to "I really don't get it". The launch of a specialized NFT gallery is brilliant particularly when one considers the existing groundwork the company has laid ahead of it. I won't give away this company's name mainly because we tend to avoid start ups. But I can tell you that the company is based in San Diego, CA and it has already figured out that NFTs are the digital glue that will connect consumers and merchants in the smarter, contactless e-world of tomorrow. The NFT gallery will allow for the creation, listing, sale, and purchase of tokens on the blockchain using a mobile payment app which the company already has. The payment app will enable customers to discover merchants and: pay, tip, and review them in a contactless way. This method of digital commerce is commonly known as "P2P" or peer-to-peer networking, and when used to distribute access to webpages is much smarter than the mainstream internet we have today. Today's internet is known as the **client-server model** and it distributes user access data to servers: the large, warm, constantly blinking wall of processors in the computer rooms of many of today's businesses keep way off in the back. The client-server model is well understood but largely at the limits of its ability to **drive outcomes** such as customer engagement, which is the precursor of sales and profitability. The company is also integrating ticket sales into its mobile payment application, for customers seeking access to live events more easily and at a lower cost. NFT ticketing provides several opportunities to event organizers. First, NFTs can be used to create unique, art-like tickets highlighting the "story" of the event to collectors and attendees. Second, ticket authenticity can be used to easily verify the original owner. Third, the ability to collect a revenue stream from the tickets each time an owner resells the NFT ticket. Fourth, access important event data to make future promotions even more successful. And lastly, easily distribute tickets through text messaging.

The company's app will connect the NFTs to mobile payment and to its own financial platform where you can eventually engage in traditional banking services like opening a savings account that helps you save money. The company's more ambitious plan is to help the underbanked or those in regions with unsophisticated banking systems do everything from their phone. The app will also allow consumers to bypass some of the costing layers associated with purchases through online juggernauts like Amazon and NFTs will be a big part of that detour.

This of course is all very nice but what the heck are NFTs (again)?

NFTs are units of data stored on the blockchain, a type of digital ledger. NFTs confirm a digital asset to be unique and therefore not interchangeable [non-fungible] with anything else. NFTs then are very different from things like fiat currencies, which are basically all the same. One Canadian dollar in your pocket is just as good as the one in mine. NFTs are unique because they are cryptographically authenticated, meaning the author or creator is verified within an immutable and unchangeable digital record. Since NFTs are unique, they are uniquely positioned to represent things of value like photos, videos, art, and songs but NFTs have applications outside the world of art. Things like insurance policies and real estate transactions might one day be fully digitized. But who would expose their assets and wealth over the blockchain for all to see? Well for starters, there's the Lobkowicz family…

[The Bohemian Prince at the centre of a digital renaissance.]

Back when the Nazis were murdering people in Europe and claiming property as belonging to the Fuhrer, they issued receipts for everything they stole. The record keeping process turned out to be tremendously helpful to Prince William Lobkowicz when he returned to his native Czech Republic in 1989 following exile to the United States. Prince William inherited a priceless collection of nearly 40,000 artifacts dating back more than 700 years.

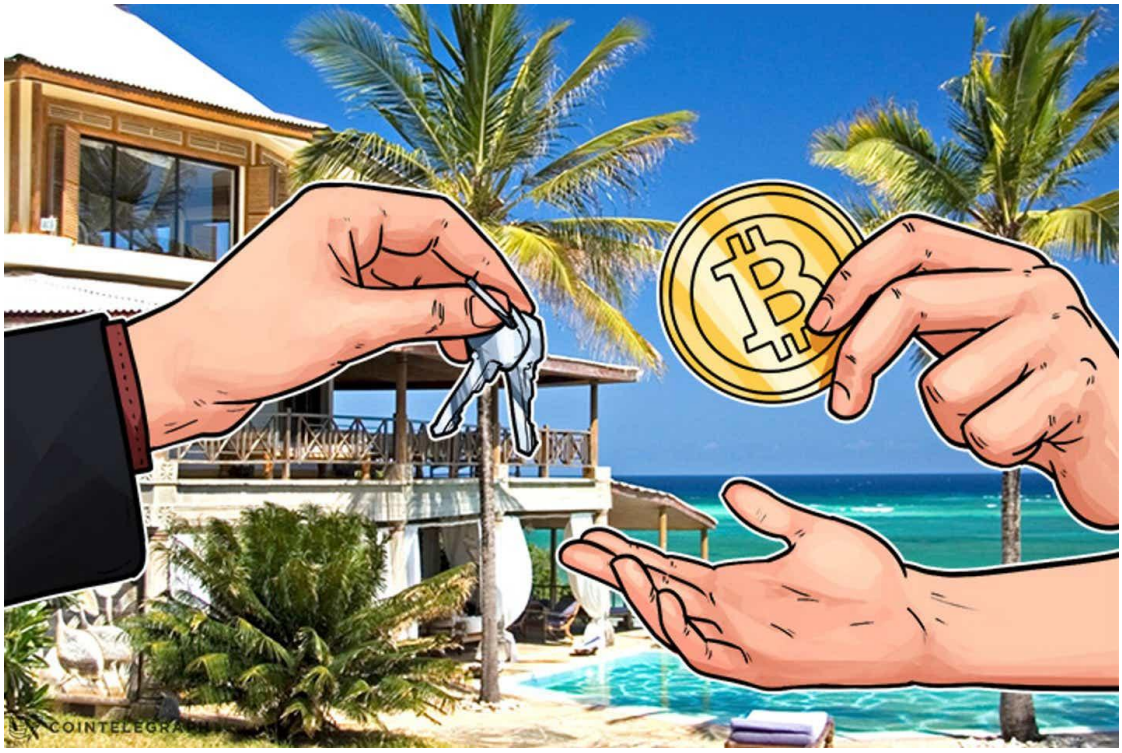
Among the more noteworthy possessions were 16th and 17th-century paintings from renaissance master Bruegel

and Spanish royal family portraitist Velázquez, as well as hand-annotated manuscripts from Mozart, Beethoven, and Haydn. Many of the treasures are prized so highly that the Czech Republic has declared them cultural treasuries that *must* remain in the country forever and be preserved. Unfortunately, a global pandemic along with a general decline in museum visitors has meant less funds for preserving art and treasures of all types. So, under the Prince's leadership, the Lobkovicz family is experimenting with the application of NFTs to tokenize the artifacts to preserve not just cultural treasures but a piece of the family's history. By using technology to share the past digitally, the family is helping to shape the future for the physical artifacts in the real world. Purchasing NFTs from the rightful owner will allow art lovers to experience the art in a new more engaging way. Peering deep beneath the canvass of a Bruegel or Velazquez with radiographic images will make buyers feel as though they were touched by the Masters themselves. But the more important matter is that through tokenization NFTs will allow owners to maintain control of the assets, avoid fraud or piracy and enhance the relationship a consumer can have with a merchant. The resulting transactions not only drive commerce, but in this situation cultural heritage. If you own the NFT *you* have the original and that is a truly *fewocious* idea.

[This is *EverLasting Beauty* by FEWOCiOUS, a work of art you cannot hang but which really did cause the Christie's website to crash.]

NFTs give the artist or original owner of the work a way of selling the work that there otherwise might not be a market for. Neither you nor I can purchase any of the Lobkovicz's family treasures even if we had lots of fiat currency on hand. The Czech government has legislated this to be so.

Hence NFTs enable the rightful owners of an asset to get paid each time the NFT changes hands and grant the owner certain rights like the ability to post the image online or set it as your own public profile picture. NFTs then make the previously, almost impossible job of authenticating original content creation a snap.



Real Estate

NFTs clearly work in the art world but could they be applied to real estate? The current process of transferring property ownership is labor intensive and pricey. Even establishing an equity line of credit on a property requires extensive papering. By tokenizing the rights to the property in the form of an NFT, transfers become much more manageable, and liquidity is enhanced. Real estate tokenization can also assist in the investment process by tokenizing large real estate deals into smaller tokens for individual investors to participate in. In 10 to 15 years, trillions of dollars in real estate will be tokenized and brought onto a blockchain for buyers and sellers to exchange. In theory, when a property owner creates an NFT for a property, it renders all other copies of the deed as irrelevant because the authenticity of the copies is easily disproven. The economic value of the real asset therefore is attached to the blockchain and that is why, much like bitcoin, NFTs hold *instrumental* as oppose to intrinsic value and their unique abilities might one day capture all documentation digitally through wallets containing driver's licenses, immunization records and even birth certificates minted by sovereign states.

The use cases for NFTs go beyond works of art and concert tickets, and we are only just scratching the surface of what the future for this unique digital asset class has in store. What ended up happening to the company that was the subject of the client email was very positive but may take some time to evolve. The company is at the forefront of a digital revolution in banking and commerce for parts of the world that don’t bank like you or me. For the rest of us, the company will help better connect with the experiences we want to have rather than the ones corporations tell us we should be having. Just like Amazon changed the world of commerce nearly 20 years ago, NFTs are positioned to do the same today.

And, just like how Amazon was criticized back then ["*Who in the world would use the internet to buy books*"?] NFTs have their fair share of detractors. For the time being, we underscore Eleanor Roosevelt's quote on the front page of *The Quarterly*, and remind investors that not that long ago, Amazon too was just another "crazy" idea.

Don't worry, we haven't paid a fortune for a bunch of random NFTs. But we are following developments in the digital payment space very carefully. Though naysayers will say things like "That will never work", it's possible they simply haven't had the opportunity to think about NFTs in a detailed way. Like the client who emailed me at the start of this article, fortune favours the bold and I would suggest that it is today increasingly unlikely that BITCOIN, NFTs or mobile payment applications go away any time soon.

The MacNicol Investment Team

Today's investment headwind is lurking clearly beneath the surface…

I have travelled a decent amount but nothing out of the ordinary when it comes to the sheer number of places I have been. Luckily, I have been able to see some truly special places. And even though I am guilty of checking out many of those last-minute vacation sites that you might know, I have tended to prioritize quality over frequency when it comes to travel. So, what is a quality vacation spot for me? That's easy, I would have to say Bora Bora. Bora Bora's quality lies in its stunning beauty and exotic pretty much everything. Bora Bora feels like you are in another world rather than merely a different location on this world. And you can be forgiven for assuming that Bora Bora isn't located here on earth. The collection of Tahitian Islands that form French Polynesia takes a bit of time to get to. The ride from YYZ to LAX is merely a warm-up. After a quick stop, you take off for the flight to French Polynesia's capital Pape'ete, which is a Toronto-to-Warsaw sized journey of its own. Then, you island hop your way from Tahiti International Airport to your final place in one of those over-the-water huts synonymous with the Island where you can begin to enjoy the scenery and one of those fancy drinks that come in a real coconut.

[That's Bora Bora in the background. If you like tropical islands, then you'll probably run out of superlatives for Bora Bora long before its time to head back to Toronto.]

"Pretty", "darn" and "exotic" are all good ways to describe Bora Bora. But another is "clear". Clear as in the fresh breeze of the Pacific Ocean and certainly it's water. You might think the water dispensed by your Thermador fridge was clear, but I can assure you, few places have water like this:

[Bora Bora's waters are clear, and loaded with sharks, stingrays, electric eels, and a whole host of other dangerous creatures.]

The trouble is…with waters so clear, seeing the risks lurking just beneath the surface is easy. Easy and anxiety inducing. During my time in Bora Bora, I often swan in one direction and simultaneously looked over my shoulder in the other. You would think that swimming in water so nice would be calm and relaxing, yet somehow it just wasn't. With stock markets - by and large – doing quite well in 2021 why do I feel a bit anxious?

The risks lurking underneath some popular investments:

Third quarter earnings reports for most S&P 500 companies have either already been reported or will be soon. On the surface, things look pretty good. In firms that reported, earnings per share have grown by 27%. Meanwhile sales have grown by 15%. These figures suggest that the pandemic's impact on the stock market is over. However, one sector we follow closely [travel and leisure] signaling to our investment team that things aren't looking so good. The CEO of a private travel tech firm we own in our alternative program, himself a long-time travel executive, tells us that despite the share price performance of certain airlines, cruise ships, casinos and resorts, things are not looking so good for the travel sector. The travel companies borrowed heavily to make it through 2020. The idea was that emergency credit facilities would help them through the painful [but temporary] period of COVID related lockdowns. The companies issued new bonds, pledged their own points programs as collateral, took on emergency credit facilities and even extended maturities of existing debt simply to cling to life. The proverbial can was kicked down the road, but vacation goers aren't returning in anything like the pre-COVID numbers seen in 2019. Demand from people stuck at home during 2020 was *thought* to be the industry's salvation once vaccination programs got underway. But that simply hasn't happened.

The more communicable delta variant of the coronavirus has made even fully vaccinated people stay home. Confusion around lockdowns and quarantining policies has seen many vaccinated travelers sit on the sidelines because quite frankly, why bother going somewhere when your return home is hazy at best?

[There are risks to swimming in Bora Bora's waters…so you need safeguards and get great advice before you dive in.]

Empty properties, vacant restaurants and unsold tickets are now going on to year 2. And though the clock is ticking for the travel sector most investors do not seem phased. One sky high example of the problem is Delta Airlines. Delta recently reported quarterly earnings of $652 million which clearly sounds like a huge profit but is blurred by the $1.5 billion government support program Delta tapped into to pay wages and fuel largely vacant aircraft to baron resorts. Excluding government capital, Delta (would have) reported a $678 million loss for the quarter. A similar story has played out over at United Airlines and American Airlines with those carriers also badly in need of government aid packages. But with Delta shares up 2 and 3 times as much as rivals United and American, one questions whether that group of investors has their heads in the clouds.

[Delta's last bankruptcy was in 2005. Planes don't make money on the ground and they only make money in the air when they are full.]

Delta of course emerged from restructuring in 2007 but not before a major restructuring took place resulting in thousands of job losses. We would not want more workers to lose their jobs at Delta but the company's sky-high ratio of debt-to-assets, and questionable prospects for travel demand concern us a great deal. Delta shares might experience a severe bout of turbulence at some point in the near future and we believe current shareholders are placing an excessive level of confidence in the stock. But be advised that other, less obvious, industries are also struggling from debt issues, a lack of revenues, inflationary problems, and supply chain bottlenecks. Earlier this year, I typed a tantrum about a $100,000 pick-up truck that I wanted to buy but wouldn't on principal alone. The $100,000 pick-up truck was partially a grievance and primarily a showcase of just how nasty problems with inflation and supply chains have become. But economics aside, just how many $100,000 pick-up trucks can any manufacturer sell? As prices have leaped into the stratosphere, volumes have plunged. The Ford F-150, GMC Sierra, Chevrolet Silverado and Ram 1500 have experienced year to date declines in sales ranging from 13.5% for the Ram to 30% for GMs rigs. The Ford F-150 sales decline of 15% is material too because Ford sells more pickup trucks than General Motors and Chrysler combined. Yet you wouldn't know it from the share prices. Ford Motor Company stock is up 78% in 2021 to date. Cruise ship operators had many of the same challenges with debt and booking volumes. What's more is that many retail and apparel companies are struggling to find their footing also. At MacNicol & Associates we are always looking at the risks that lurk beneath the investments we make for you and your family. And they aren't always as obvious as a Hammerhead shark swimming directly towards you in crystal clear water. There is also an adaptability in our process that makes it relevant in real-time. One example of this is our queries to corporate managers about whether the liquidity gains they have made in their businesses over the past 6-to-12 months are sustainable in the long-term or simply there to keep the lights on for one more quarter. Whether you let us do the investing for you or simply read our commentaries for perspective, the liquidity question is hands down one of the most important for investors to ask these days.

To conclude, Bora Bora is beautiful and a place you should definitely visit if you haven't been. The S&P 500 at nearly 4,600 points was also a place that investors were well advised to just visit earlier in the summer. At MacNicol & Associates, we have been warning investors about the potential for a correction in financial markets for some time. We thought positions in hard assets and gold along with elevated reserves of cash were not always popular decisions but ones we ultimately had to make based on the data we reviewed, and the headwinds we feel investors are most likely to face. Today's greatest investment headwind therefore isn't a creation of a Central Bank or the Chinese Government, it's each of us. We need to stop thinking the future will be like the past.

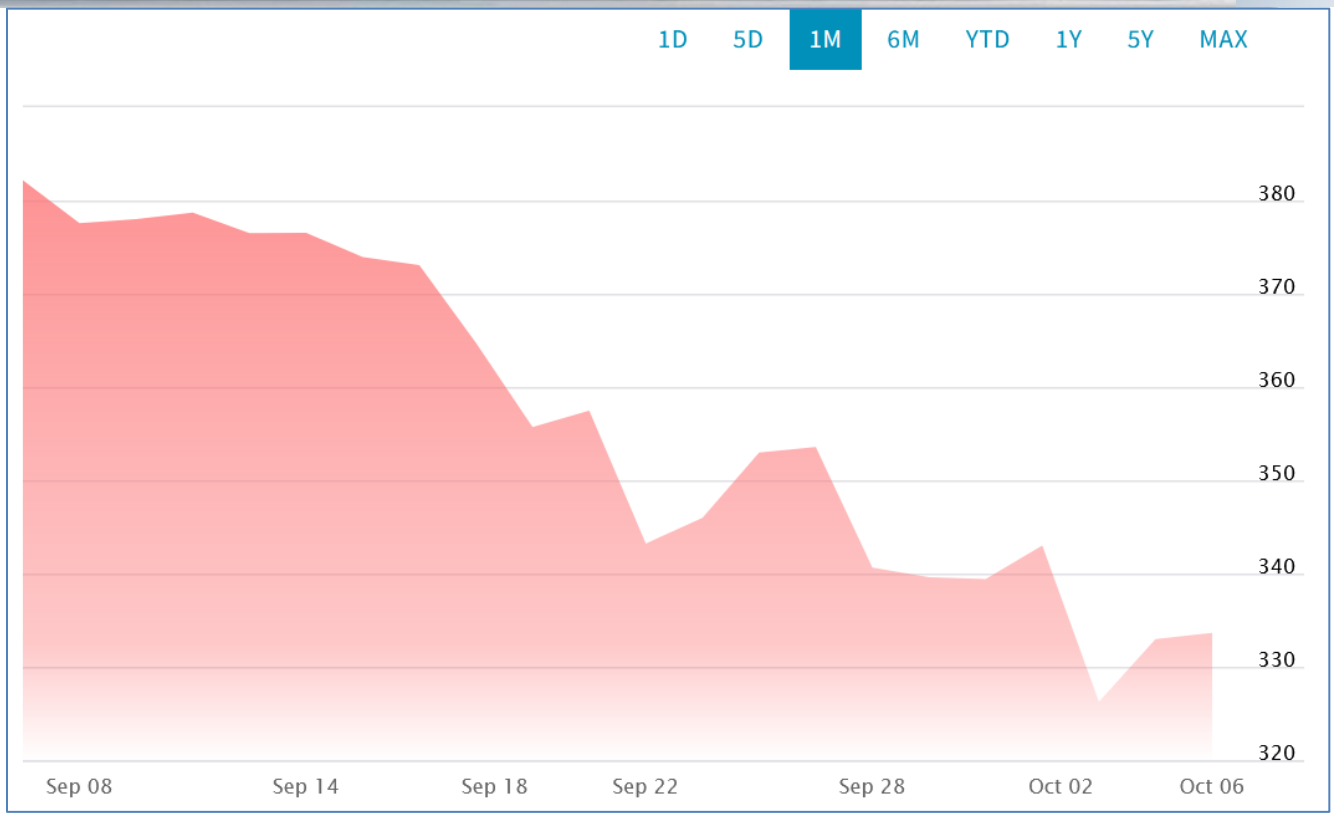
The MacNicol Investment Team

Overconfidence: bad on the fairway, worse in your portfolio…

For those of you who joined us for our 20th anniversary celebration either virtually or in person, you'll know that golf was the thematic backdrop for the evening's festivities. Rosedale Golf Club was the venue and PGA Professional Erik Compton was David's guest speaker that evening. Although I can't even begin to imagine how David makes some of the shots, I have seen him make, I imagine that David can't even begin to imagine how Erik Compton has made some of the shots fans of the sport have seen him make in his career. Being in the presence of great athletes or great minds can be a humbling experience, so too can being in possession of great profits, especially if you let them get to your head…

[PGA Golf Pro Erik Compton can confidently swing a club. Confidently and courageously.]

Let's suppose you recently opened an online trading account for a little do-it-yourself-investing. Let's further suppose that, you happen to have purchased shares of a small oil and gas producers a few weeks ago. Finally, let's suppose that this morning, you logged into your online trading account and voila saw profits. One obvious reaction would be to think to yourself "*Ha..this isn't that hard*". Perhaps that's why in your next investment foray you double up on the amount of capital you are willing to risk but this time choose the "higher octane" world of tech stocks…say **Facebook** for instance.



[Facebook shares have experienced the sort of back-to-school period thus far in 2021 that would make investors want to "unfriend" the stock. In fact, during one recent trading session, CEO and Founder Mark Zuckerberg lost nearly $6 billion in a matter of hours. If its any consolation, I lost a five-dollar bill in my sofa once.]

Investment overconfidence is a problem, and it is a fairly large one at that. So widespread is the issue of investor overconfidence that the CFA program devotes an entire section of the curriculum to **behavioral finance** – with you guessed it – an Albatross[1] sized reading on **overconfidence**.

The CFA Institute, along with many academic researchers have worked hard to study the impacts that overconfidence can have on investment decisions and results. The research demonstrates that overconfidence can lead to investment errors, as well as the mispricing of assets. What's more, studies into overconfidence demonstrate that investors are not always fully rational, in other words they aren't economically logical in their actions and actually let stocks and companies get in their heads. Kent Daniel and David Hirshleifer, authors of the paper *Overconfident Investors, Predictable Returns, and Excessive Trading*, talk about how overconfidence can actually function to erode returns rather than enhance them.

They also show that the more actively investors trade (due to overconfidence of course), the more they typically lose. The stocks that individual investors buy tend to subsequently underperform, and the stocks they sell tend to subsequently outperform.

[1] An *Albatross in golf* means scoring three shots under par (-3) on a hole and it is a big deal.

A cognitive process that helps support overconfident beliefs is **self-attribution bias** which is where people credit their own investment "acumen" for past successes, such as making a quick profit in oil and gas stocks, while blaming their failures on bad luck, such as Facebook's outages or poor executive leadership. Self-attribution bias allows overconfidence to persist.

[Relax, we get it: you're overconfident…it's okay.]

Luckily at MacNicol & Associates, we aren't overconfident. We are confident sure, but not overly so. And it isn't because we have some sort of unique connection with our own inner cognitive processes. Rather, its because we are a well-trained team of dedicated investment professionals that meet regularly and challenge each other's views on financial markets, the economy and whether small cap energy stocks are indeed more (or less) risky than companies like Facebook. Whether you invest for yourself or have us do it for you, always keep in mind that overconfidence can actually *prevent* you from becoming a great investor. And if you ever get a chance to speak to Erik Compton, which I highly recommend, you'll get a chance to look into the eyes of a truly courageous man. Courageous about life and confident about golf, but not overly so. Remember, Erik Compton like many PGA Professionals have taken more lessons, practiced more swings and spent more time in simulators than each of us combined, including David.

The MacNicol Investment Team

Firm Wide News

We are proud and happy to have celebrated our 20th Anniversary this September. We hosted a party at Rosedale Golf Club and although the weather did not cooperate, we had a good turnout. We were thrilled to have PGA Tour Player Erik Compton as our guest speaker. Erik spoke to us for about an hour. Not only did he have some interesting stories about his experience on the Tour, he also spoke about his journey as a two time heart transplant recipient. His stories were both fascinating and inspiring. For those of you who were unable to make our reception, the link to the event is on our website. Thank you for all of your support over the past 20 years.