MacNicol & Associates Asset Management Inc.

December 2022

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 behavioral 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.

"Money flows into most funds after good performance, and goes out when bad performance follows"

- John Bogle

The Numbers:

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Index:		**2022 YTD:**
S&P/TSX:		- 3.6%
NASDAQ:		- 26.7%
Dow Jones:		- 4.8%
S&P500:		- 14.4%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	4.20%	4.27%
5-Year Bond:	3.06%	3.78%
10-Year Bond:	2.86%	3.58%
30-Year Bond:	2.83%	3.56%

Economic Data:

- Stocks higher in November
- Canadian dollar rises on Bank of Canada rate move
- Metals ex-Cobalt higher in the month
- Gold up 7% in November
- Crude oil down 7% in November
- Bitcoin continues its slide in November off over 60% for the year
- Agricultural commodities and fertilizer prices mainly lower in November

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	20	24
P/B: Price-to-Book	4.0	4.5
P/S: Price-to-Sales	2.4	2.9
Yield: Dividend Yield	1.6%	1.7%

2022 Year to Date Performance, by Sector: Nov 30th, 2022

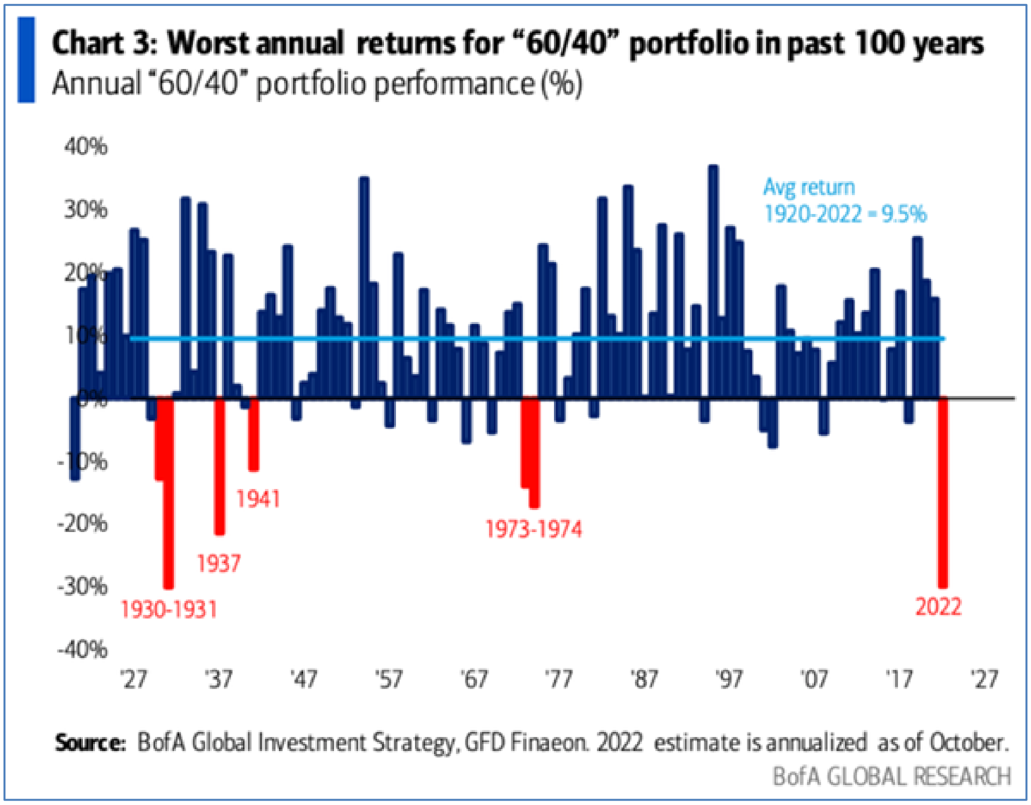
S&P/TSX Composite	-3.6%
NASDAQ	-26.7%
Dow Jones Industrials	-4.8%
S&P 500	-14.4%
Russel 2000 (Small Caps)	-16.0%
MSCI ACWI ex-USA	-12.9%
Crude Oil Spot (WTI)	7.0%
Gold Bullion ($US/Troy Ounce)	-3.9%
SOX Semi-conductor Index	-28.3%
VIX Volatility Index	19.5%

Source: Canaccord Genuity Capital Markets & Thomson Reuters

Foreign Exchange - FX

As of December 13, 9:00 AM	$5,000	Cdn		
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.354	$3,693	$(1)	0.0%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.3970	$3,579	$(114)	-3.2%
Raymond James	1.3810	$3,621	$(73)	-2.0%
Royal Bank	1.3816	$3,619	$(75)	-2.1%
Scotia	1.4006	$3,570	$(124)	-3.5%
TD	1.3896	$3,598	$(95)	-2.7%
Canadian Snowbird	1.3526	$3,697	$3	0.1%
Spot Rate	1.3537	$3,694	$-	0.0%

***Financial* imbalance…**



Bank of America recently circulated a chart showing the performance of a traditional balanced portfolio over the last 100 odd years. I would not call it a flattering chart, bright red bars were used to highlight some of the portfolio's more severe drawdowns and assuming 2022 concludes as Bank of America (and we) suspect, 2022 will be one for the ages and investors will be able to see *that* bright red bar off and on for the next 50 years.

The corrective periods in stocks during the 1980s (1982, 1988) the 1990s (1990, 1998) and the early 2000s (2003, 2009) were offset by traditional fixed income securities, such as bonds, which stepped in to insulate balanced portfolios from the carnage in the stock market. But in those periods, fixed income positions offered investors yields as high as 16% (1982). Those days are long gone. But we detect a chance looming over the horizon, and we will probably skip out on the Eggnog this year as a result. We helped more investors this year than any other in our history, but I think we can do even more to help investors deflect those annoying bright red bars.

Over the horizon…

We are now beginning to see some very early signs that better times for financial markets are coming, and we believe that investors with *excessively* high levels of cash should pay attention and be ready to act soon. This view is anchored by our hunch that inflation could be entering a peaking process based on observable market data. Movements in long-term interest rates, a robust improvement in cyclical areas of the stock market and improving conditions in the credit market suggest that investment returns in 2023 might be an improvement over 2022's dismal campaign. Yes, inflation is still high, but the pace at which inflation is rising has declined materially.

[After rising for 26 months, the yield of the 10-Year Government of Canada as well as several other G7 notes has begun to fall.]

Need to recede?

During this past summer, the tone of our commentaries was cautionary: a Canadian recession was possible though not guaranteed. As 2022 entered its swan song month, we felt that prospects of a recession were real, but frankly lower than earlier in the year. If the Canadian economy does indeed recede, positive adjustments to the economy's foundations should serve to make it less ferocious. And our friends in the United States are also feeling better about themselves and this is reflected in a material change in tone of their own Central Bank, the US Federal Reserve.

Page 9 of the November 1-2, 2022 Federal Reserve Meeting Minutes, which can be found here: https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20221102.pdf contained a sentence in paragraph six, that I felt sufficiently compelled to: cut, paste, circle and highlight poorly below mostly due to the fact that I lack even a modicum of graphic design talent but also because I was quite excited when I read this at home.

> Participants mentioned a number of considerations that would likely influence the pace of future increases in the target range for the federal funds rate. These considerations included the cumulative tightening of monetary policy to date, the lags between monetary policy actions and the behavior of economic activity and inflation, and economic and financial developments. A number of participants observed that, as monetary policy approached a stance that was sufficiently restrictive to achieve the Committee's goals, it would become appropriate to slow the pace of increase in the target range for the federal funds rate. In addition, a substantial majority of participants judged that a slowing in the pace of increase would likely soon be appropriate. A slower pace in these circumstances would better allow the Committee to assess progress toward its goals of maximum employment and price stability. The uncertain lags and magnitudes associated with the effects of monetary policy actions on economic activity and inflation were among the reasons cited regarding why such an assessment was important. A few participants commented

[Source: US Federal Reserve Meeting Minutes from the November 1-2, 2022 meetings, page 9.]

A slowing in the pace of interest rate hikes indicates that policy makers are now poised to assess the economic landscape and see where they are in terms of meeting their objectives regarding inflation and price stability. This will help stabilize the housing market, which tends to favor steadfast pricing even if pricing is high. Certainly, optimal market returns occur when interest rates remain unchanged for longer periods of time. We are not exactly sure that rates will remain uniform for an indefinite period. But we absolutely feel that we are now closer to **the end** of the current tightening cycle than the beginning and that the worst thing investors can do is delay, defer and not deal with the subject of cash stockpiles or that pile of mutual fund statements from the bank.

What about the stock market?

Cyclicals…

Using Yahoo Finance's basic, yet still highly informative charting function, I cherry picked holdings that I felt represented more cyclical areas of the stock market. In theory, the stock market is a leading economic indicator, which should react first and if that's even remotely true cyclical areas of the stock market should experience a jump. To avoid a "headache chart" congested with too many lines, I popped in the iShares US Home Builders ETF ("ITB" above), a single fund that represents several large US home builders. There is admittedly a lot that I did not include here, and you are welcome to evaluate my argument with your own list of cyclical stocks. But to me, it does look like economically cyclical areas of the stock market have begun to show signs of life. Rockwell Automation ("ROK" above) and CN Railway ("CNR.TO" above) are up over 20 percent in just the last six months. US home building stocks have risen by just over 8% during the same time. And even Caterpillar ("CAT" above) has done okay during this period with its own 5.6% return. Remember we are not suggesting that investors go full bore into stocks, but after 12 months of safe positioning, we are suggesting that economic momentum will improve by this time next year and that the stock market will catch wind of this many months ahead of time rewarding those who act sooner and frustrating those who act only when the said momentum became glaringly obvious. Our third and final positive data point here is the encouraging developments we have witnessed in the credit market. Debt can be insured by a kind of derivatives contract known as the Credit Default Swap or "CDS". CDS prices are falling significantly as shown in the table below. Yes, it is somehow difficult to get one's head around a negative number displayed in green so keep in mind that CDS prices represent the cost to insure against a credit default event. In other words, the derivatives market is *less* concerned (not concerned) about a severe recession that would trigger extensive defaults.

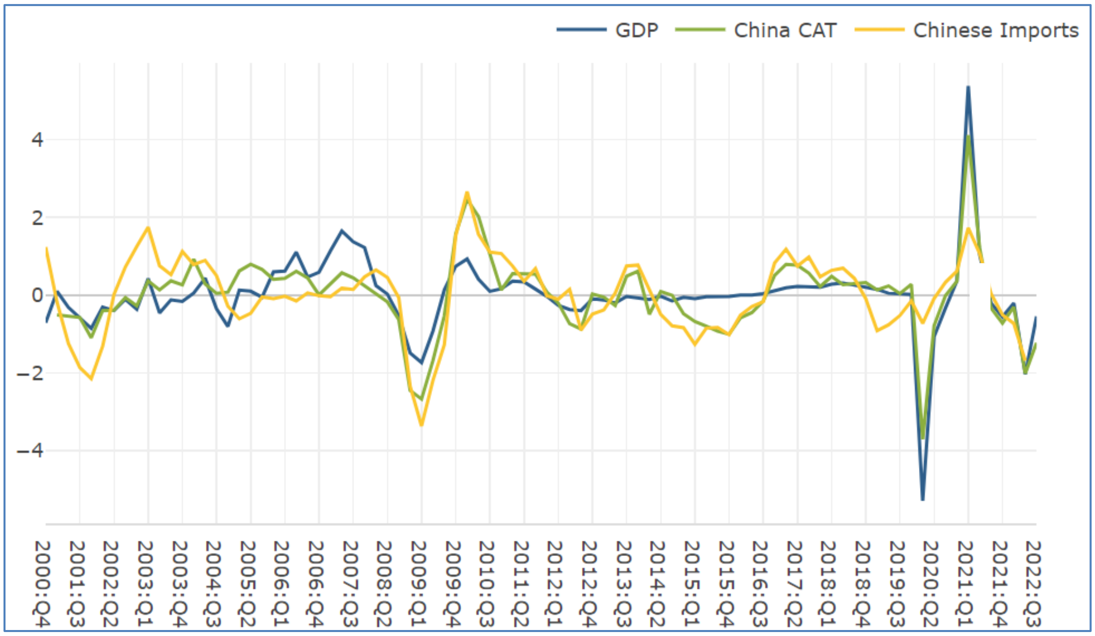
Period	Change	Min	Range	Max
1 Week	-9.06%	25.00 7 Dec 22		27.49 6 Dec 22
1 Month	-17.41%	25.00 7 Dec 22		30.27 11 Nov 22
6 Months	+55.28%	16.10 11 Jun 22		30.58 4 Nov 22
1 Year	+83.82%	10.70 22 Mar 22		30.58 4 Nov 22

Good riddance…

2022 was a lousy year in many financial markets. The 1-2 punch of lower stock prices and lower bond prices left many with a feeling of financial imbalance when balance was traditionally sold as a good thing. In some cases, pivotal life decisions like retirement, a major renovation or helping a student with college or university were drastically adjusted by 2022's fury. But as you have just read, the clock is not only ticking when it comes to the ball being dropped at Time's Square. 2022's days are numbered and so too are the days of patiently sitting on the sidelines. Any urgency in our tone today is really intended to get you thinking about thinking about markets, the economy, and your portfolios. At MacNicol & Associates Asset Management, we will continue to be careful, and you should too but keep in mind, every now-and-again, the best defense is a strong offense.

The holy grail of humor…

There have been a handful of times in my life when I laughed so hard that I nearly died. One of those times was when I first watched *Monty Python and the Holy Grail*. When John Cleese's character *Sir Arthur* began to trot on a "noble steed" (coconut shells knocked together by Cleese's partner creating an equestrian charade) I laughed with such hysterical vigor that I was temporarily unable to breathe. The site of grown men using coconut shells to signify equine status was comedic genius, as was the debate Sir Arthur later had with a presumed adversary who incredulously suggested that the horse did not exist. Believe it or not, Cleese and his partner were not displaying great comedic writing but rather a budgetary restriction the Holy Grail's producers were experiencing at the time. I guess horses were expensive. Along these same lines, I recently enjoyed a good laugh reading a report on China's zero COVID policy. To be clear, COVID is not funny, and I would never joke about that. But just last month, I told you about President Xi Jinping's third mandate and how it included things like a new cohort of officials handpicked by Xi and no upper limit on the number of mandates he can serve. What I neglected to mention in that piece was that China, under Xi's direction, is using COVID lockdowns as a scapegoat for diminished economic activity when in fact the diminished economic activity can be explained by something a lot more simple: diminished economic activity.



[The China CAT index measures fluctuations in Chinese economic activity by combining eight non-GDP indicators to measure deviations in year-over-year growth relative to trend. John Fernald, Eric Hsu and Mark Spiegel of the Federal Reserve Bank of San Francisco developed "CAT". Fernald, Hsu and Spiegel also penned a staggeringly interesting August 2019 paper entitled "*Is China Fudging its GDP Figures*"?]

Unfortunately, China's reactions to COVID and its interpretation of economic data are comical but the protests that have erupted across the country thanks to what was already an ugly job market are not. Too many super bright applicants jostling for too few jobs is not a good situation. Beyond thwarting the positive forward momentum of China's youth, recent developments in China's economy could erase decades of economic prosperity and soon make it out of reach for some very hard working and intelligent people. Chinese unemployment among younger citizens remains close to the highest levels on record. And we doubt the situation will improve any time soon. Next year, Chinese colleges and universities will stamp out 12 million new graduates and that is a lot of hungry people set to join the work force. Protests on the part of Chinese students recently reached a zenith because not only because of the situation itself but because there did not appear to be impetus on the part of China's government to help. The lack of political leadership, rather than the understandable fact that all economies go through cycles, is what roiled students…and investors. Last month, we referenced that in Mr. Xi's 2-hour "coronation" he somehow managed to reference the communist party 142 times, socialism 81 times but the Chinese economy not even once. It is this sort of blatant and willful lack of situational awareness that has affected more than just a handful of ruling tech executives or real estate developers. Chinese citizens are beginning to resent the lack of focus, and the pretense that COVID lockdowns (not poor management) are causing China's economic growth initiatives to flounder.

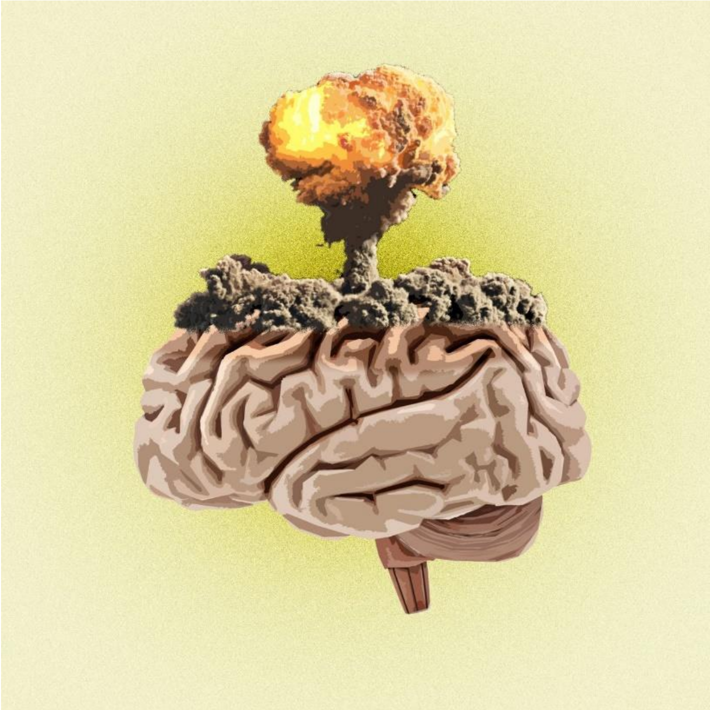
Back in 2017 President Xi was quoted as saying “a nation will prosper only when its young people thrive”. China’s youth want to work and be successful, and their scores in traditional and alternative S.T.E.M. subjects is proof of their immense talent. Xi’s quote then undermines their efforts and the credibility of his position as leader. Clearly the government of China has made an about face on COVID restrictions, what more opaque is the whole thought process that goes into making flip-flop decisions without understanding their implications. The broader implications of a government more concerned with loyalty than (economic) reality are that like its youth, it is the nation that will fall behind.

Late in the third quarter of this year, the World Bank forecasted China’s GDP growth rate to reach just 2.8% this year while the rest of the 23-country Asian pacific region was expected to grow by 5.3%. By far one of the world’s largest economic growth engines, China is now on pace to deliver growth that is one-half of the average country in Asia, and this has a lot of investors like us looking at other countries such as India, Vietnam, Cambodia, and Laos. Chinese stock markets have rebounded a bit, but the country remains laughably out of touch with problems that could over time leave a lasting, indelible mark.

Sir Arthur had his partner use coconut shells to make us believe he was riding a great stallion. China is using totalitarianism and a bogus COVID pretense to make its citizens believe it is doing what is best for its people. Sir Arthur convinced absolutely no one that he was riding a real horse and the government of China is convincing none of its citizens that it is serious about taking real measures to right the nation’s economy. We have not made any investments in China, and it is not because the Chinese lack drive or enterprising spirit. It is because until we begin to see progress made on the part of the government’s desire to run the country more effectively, we will simply be smashing together coconut shells instead.

Behavioral Investing: past performance is no guarantee of future results

Most experienced investors know that past performance is no guarantee of future results. Despite this widely issued investing caveat, investors often struggle to heed its warning. Instead, investors function under the powerful telekinetic grip of **outcome bias**; where it is assumed that superior results must be the consequence of skill and will therefore persist, and poor results foreshadow ongoing agony. Outcome bias leads to the economically disadvantageous behavior of performance chasing where investments in recent winners are made, and laggards or overly conservative asset allocations are shunned.



As 2022 concludes, many of you might be sitting on elevated cash positions, or positions in the shares of companies that have performed poorly during the year. All of this might not feel that good and the natural temptation to look at what worked in 2022 is certainly there. But thinking or hoping it might be prudent to simply just add to this year's winners is no guarantee that you will feel better about your finances next year. Whilst such an activity may give you some near-term relief, it comes with a steep price tag and that is suboptimal for long-term investment returns. In unpredictable financial markets relying on historic performance as a primary measure for quality is fraught with problems. So, speak with us, we cannot guarantee outcomes, but what we can guarantee is that we will always listen to your needs and give you our own independent and unbiased view about what you should do with your investments.

The MacNicol Investment Team

Firm Wide News

Edward Biding has moved back out to Saskatchewan and has decided to move on from MAAM. The MacNicol team is pleased to announce that Ruchi Aggerwal has joined the firm in the role of Portfolio Administrator.

Ruchi has extensive experience in business and financial data analysis and client services. She has a track record of success in business analysis, reporting, coordinating, and supporting teams by training and coaching new hires with a strong attention to detail and deliver excellent client service. She has worked in the Financial Services industry for over 15 years, Mackenzie Investments being her last employer. She lives in North York with her family and has 2 children aged 16 & 12.