February 2023

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.

"In academia there is no difference between academia and the real world; in the real world there is…"

- Yogi Bear

The Numbers:

Index:		**2023 YTD:**
S&P/TSX:		7.13%
NASDAQ:		10.68%
Dow Jones:		2.83%
S&P500:		6.18%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	4.52%	4.78%
5-Year Bond:	3.29%	3.93%
10-Year Bond:	3.13%	3.72%
30-Year Bond:	3.14%	3.78%

Economic Data:

- Good start for global equities in January
- The Bank of Canada and US Federal Reserve hint to a pause in rate hikes
- Chinese inflation data a potential concern in 2023
- German Chancellor Olaf Scholz visited Chile to firm up supply chains for battery metals
- The IMF revises lower its 2023 global economic outlook due mainly to inflation and the conflict in Ukraine

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**

2

2023 Year to Date Performance, by Sector: Jan 31st, 2023

S&P/TSX Composite	7.13%
NASDAQ	10.68%
Dow Jones Industrials	2.83%
S&P 500	6.18%
Russel 2000 (Small Caps)	6.3%
MSCI ACWI ex-USA	8.92%
Crude Oil Spot (WTI)	-2.13%
Gold Bullion ($US/Troy Ounce)	5.63%
SOX Semi-conductor Index	20.15%
VIX Volatility Index	-19.8%

Source: Canaccord Genuity Capital Markets & Thomson Reuters

Foreign Exchange - FX

As of February 13, 2023 09:00 AM EST	$5,000	Cdn		
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.3361	$3,742	$(0)	0.0%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.3695	$3,651	$(92)	-2.5%
Raymond James	1.3458	$3,715	$(27)	-0.7%
Royal Bank	1.3634	$3,667	$(75)	-2.1%
Scotia	1.3707	$3,648	$(95)	-2.6%
TD	1.3788	$3,626	$(116)	-3.2%
Canadian Snowbird	1.3413	$3,728	$(15)	-0.4%
Spot Rate	1.3360	$3,743	$-	0.0%

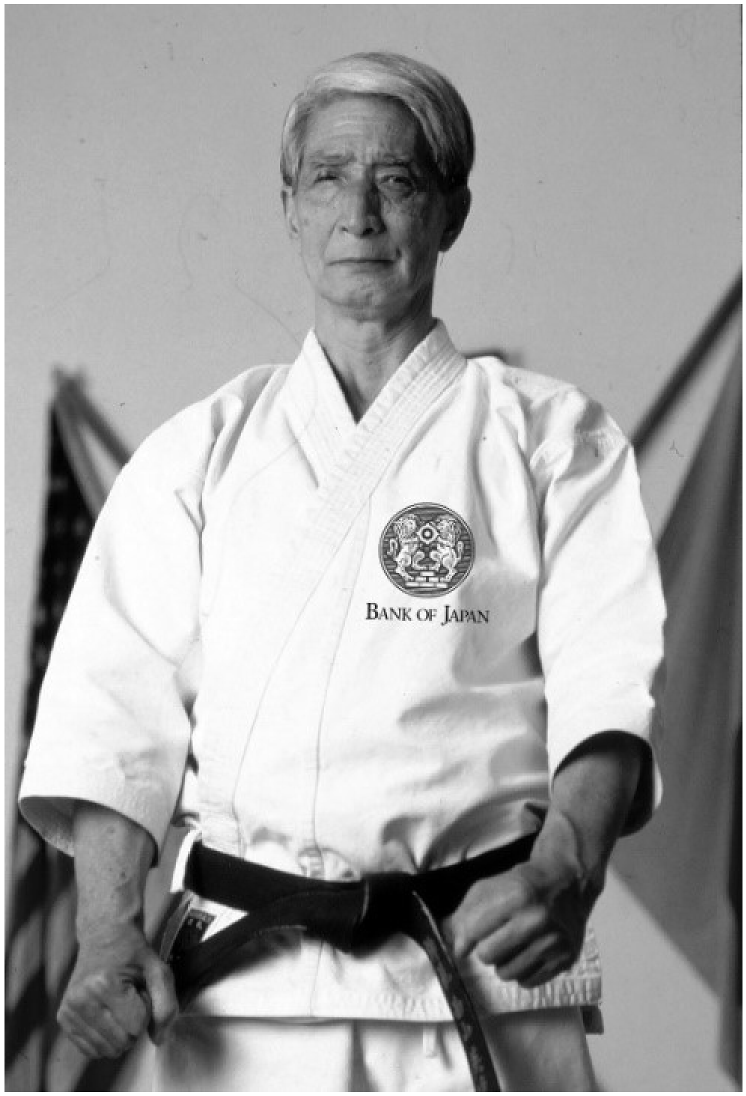
Land of the rising…*rates*…?

God, I loved Karate. As a young man, some of my fondest memories were of being beaten to a pulp by instructors from many backgrounds but a common passion for the art. Given Karate's origins, it was somewhat strange that not a single Sensei of mine was Japanese. Not that it matters: "ouch" is a universally understood term and it was mainly the Scottish and the Italians who I trained under. Both sets of teachers pulverized me with thunderous shots that I am sure were heard from my native Mississauga, Ontario all the way to Okinawa. Karate literally means the **empty, hand, way**. Though Karate's physical aspects seek the development of skill in defensive and counteroffensive body movements principally through striking or kicking, its moral aspect seeks the development of skill at improving the overall individual. More than anything else, Karate teaches one to progress wisely: in the art itself and in life, and pragmatic examples of this are part of Karate's fabric and folklore.

空手

It is in this context that we felt it worthwhile to discuss the present situation at the Bank of Japan (BOJ). Japanese monetary policy over the past 25 odd years is historical record and therefore subject to extremely narrow interpretations except in regard to whether the BOJ achieved anything or not. Governor Haruhiku Kuroda's term at the BOJ expires in April and we doubt Mr. Kuroda stays even a single day after retirement. Kuroda's successor will undoubtedly need his or her counteroffensive monetary movements to be sharp. What's more, we feel a strong argument can be made for Jerome Powell to strongly consider the totality of the Japanese monetary experience lest

The Fed pulverize American consumers and businesses. So…who do we feel is the front runner for the BOJs top job? This guy…



[The MacNicol Investment Team feels this fellow may be the Bank of Japan's next Governor, please do not kick or punch us if we are wrong!]

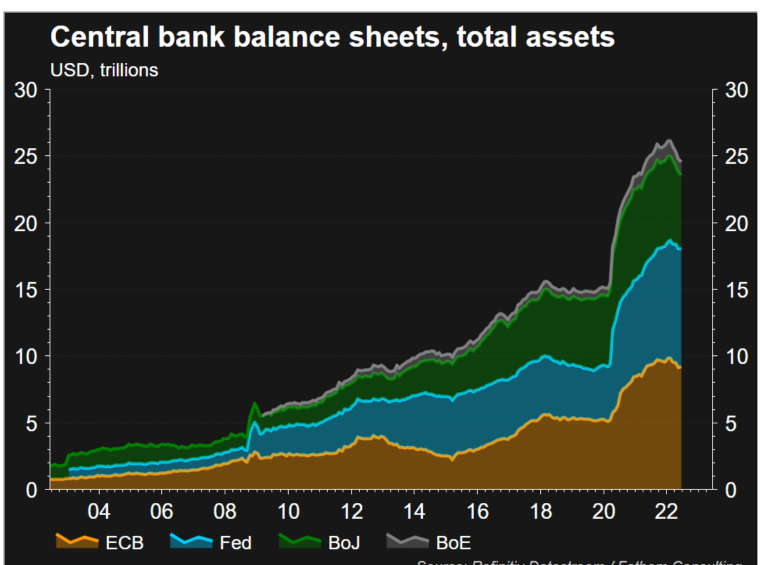
The Bank of Japan (BOJ) has been an accidental monetary pioneer for over two decades. It started in 1999, when the BOJ cut benchmark interest rates to zero. The world's first experiment in quantitative easing had thus begun. Quantitative easing is when a central bank buys financial assets to inject money into the financial system. Decidedly radical and provocative at the time, quantitative easing has since become standard operating procedure for the Fed, the European Central Bank, the Bank of England, the Reserve Bank of India, and many peers. The practice of quantitative easing has led to central bank balance sheets that are bigger than most mountains and financial distortions where investors buy bonds for capital gains and stocks for income purposes. And it has been argued that the practice fuels speculative, mainly credit fueled asset bubbles not only in stocks but in real estate and other asset classes. At the same time, it is hard to argue that policy makers like Mr. Kuroda or his predecessor Masaaki Shirakawa errored during their respective tenures at the BOJ. In fact, Mr. Shirakawa's mandate was described as "to respond to changes in circumstances in a flexible and timely manner". Sounds simple enough (like a kick or a punch) however applying it in the proper circumstances is much more challenging. And here are the circumstances Kuroda, Shirakawa and all BOJ heads have been facing…

Population of Japan (2020 and historical)

Year	Population	Yearly % Change	Yearly Change	Migrants (net)	Median Age	Fertility Rate	Density (P/Km²)	Urban Pop %	Urban Population	Country's Share of World Pop	World Population	Japan Global Rank
2020	**126,476,461**	-0.30 %	-383,840	71,560	48.4	1.37	347	91.8 %	116,099,672	1.62 %	7,794,798,739	11
2019	**126,860,301**	-0.27 %	-341,891	71,560	46.7	1.40	348	91.7 %	116,322,813	1.64 %	7,713,468,100	11
2018	**127,202,192**	-0.24 %	-300,533	71,560	46.7	1.40	349	91.6 %	116,521,525	1.67 %	7,631,091,040	10
2017	**127,502,725**	-0.20 %	-260,540	71,560	46.7	1.40	350	91.5 %	116,693,276	1.69 %	7,547,858,925	10
2016	**127,763,265**	-0.17 %	-221,868	71,560	46.7	1.40	350	91.4 %	116,835,097	1.71 %	7,464,022,049	10
2015	**127,985,133**	-0.09 %	-111,444	71,627	46.4	1.41	351	91.4 %	116,944,428	1.73 %	7,379,797,139	10
2010	**128,542,353**	0.03 %	43,247	55,516	44.7	1.34	353	90.8 %	116,741,034	1.85 %	6,956,823,603	10
2005	**128,326,116**	0.13 %	160,388	32,840	43.0	1.30	352	86.0 %	110,340,709	1.96 %	6,541,907,027	10
2000	**127,524,174**	0.18 %	231,738	-20,067	41.2	1.37	350	78.7 %	100,303,716	2.08 %	6,143,493,823	9
1995	**126,365,484**	0.30 %	372,049	9,257	39.4	1.48	347	78.0 %	98,593,178	2.20 %	5,744,212,979	7
1990	**124,505,240**	0.43 %	524,352	-59,668	37.3	1.65	342	77.3 %	96,298,507	2.34 %	5,327,231,061	7
1985	**121,883,482**	0.68 %	813,308	10,000	35.0	1.76	334	76.7 %	93,507,944	2.50 %	4,870,921,740	7
1980	**117,816,940**	0.94 %	1,080,716	41,001	32.5	1.83	323	76.2 %	89,755,553	2.64 %	4,458,003,514	7
1975	**112,413,359**	1.39 %	1,496,822	142,987	30.3	2.13	308	75.7 %	85,121,987	2.76 %	4,079,480,606	6
1970	**104,929,251**	1.28 %	1,296,450	164,541	28.8	2.04	288	71.9 %	75,417,163	2.84 %	3,700,437,046	6
1965	**98,447,002**	1.00 %	954,677	-30,270	27.2	2.03	270	67.9 %	66,812,422	2.95 %	3,339,583,597	5
1960	**93,673,615**	1.02 %	931,072	-20,000	25.4	2.17	257	63.3 %	59,269,408	3.09 %	3,034,949,748	5
1955	**89,018,257**	1.46 %	1,243,235	0	23.6	2.96	244	58.4 %	52,005,319	3.21 %	2,773,019,936	5

[I will admit, this is a "busy" data table of Japan's population over the past 65 odd years. So I will direct you to the column of median age. 48.4 years old is hardly "old" for an individual citizen, but it is very old for a nation as a whole. Older people don't produce a lot, and older people don't consume a lot except for healthcare, so their contributions to overall economic zest are smaller.]

Thus, at some point, bond buying began in earnest. And it was just bonds, nor just the BOJ that ballooned their own balance sheets to respond to changes in circumstances in a flexible and timely manner – even if most G7 nations have detailed demographic statistics about their country's citizens stored somewhere.



[This chart from Refinitiv and Fathom shows that the BOJ was hardly alone. Note that these figures are in trillions $.]

Though a Karate Master would seem to be the most appropriate next leader for the BOJ, whomever Japan ultimately inserts into the role will have to be **firm**. But while the Japanese can expect a new central bank Sensei in weeks, Jerome Powell’s term as head of the US Federal Reserve expires in January 2028. Japan can usher in a new monetary order while the Americans seem stuck with Mr. Powell. Whether or not this is a bad thing remains to be seen. But it does lead to an obvious question, which is whether The Fed will ignore the lessons learned from Tokyo or harness them? There are 3 important lessons worth heeding. First, unconventional monetary policy warps market dynamics. In 2010, the BOJ added ETFs to its “buy list”, presumably because “just” buying government bonds wasn’t enough to bolster corporate and household sentiment due to sharp declines in the stock market. ETF buying wasn’t transient or temporary either. By June 2018, the bank ranked as one of the 10 largest investors in more than a third of Japanese public companies. As the coronavirus hit global stock markets in 2020 and 2021, the BOJ doubled its annual target purchasing (of stocks) to roughly $112 billion US, but the intervention did not make Japanese companies more competitive, efficient, or productive. Backstopping share prices of course helped the rich but it did little to catalyze a tsunami of innovation or CEO accountability to shareholders. As a matter of fact, the opposite might be true. The BOJ's largesse is deadening the urgency for change.

Next, quantitative easing does little for the real economy. Corporate managers harness the activity to speculate on higher risk ventures such as buying out a rival or entering a new, unproven market. It also does not incentivize the Japanese to deploy mountains of cash or to be more productive. Evidence linking quantitative easing, particularly the purchase of equity ETFs to a surge in new investment is extremely hard to come by because it doesn’t exist. Instead, the practice led to an almost completely useless consumption cycle fueled not by cash flows but by credit. Everyone knows the stock market is not the real economy, yet leaders not just at the central bank but the wider government seem to feel that underwriting stocks will allow them to face off against tough contests in the economy and with political rivals.

[Haruhiku Kuroda’s term as Governor of the Bank of Japan expires in April, and by the looks of it, Mr. Kuroda will not be sticking around after his last day.]

The final point and this most important time is that as of yet, quantitative easing seems almost impossible to unwind. There has been much said about the unwind however consumers remain saddled with debt, corporate executives rarely purchase shares in their own companies with their own money and political leaders know better than to enter into a debate on more central economic issues. Extraordinary monetary policies become normalized rather quickly. As of the midway point of last year, the BOJ held approximately 80% of Japan's ETFs on its own balance sheet, which equates to roughly 7% of the entire Japanese stock market. Alas, consumers and businesses, and of course politicians, get used to free money. It is much easier to push your problems down the road than to face them head on as all students of Karate at some point or another have to do. In Karate, your rank is not given it is earned. Unwinding the BOJ's huge bet on stocks is something it will have to earn. It is far from a given that unloading millions of units of ETFs will be any easier than selling the bonds it bought without causing turmoil. What's more, ETFs in theory do not mature. Mr. Powell for his part, again in theory, simply allows government bonds to reach their terms. Since ETFs must be actively sold, they may be on central bank balance sheets long after Governor Kuroda rides off into retirement.

Brazen (or desperate) behavior comes with risks such as the risk of loss. The BOJ recently acknowledged that it is sitting on as much as $28 billion of unrealized losses due principally to its stockpile of ETFs. That could mean an annual loss on the BOJ's balance sheet, a first in almost four decades, should increasing COVID-19 cases or any other sort of economic Black Swan wash ashore. The gravity of this situation should really attract more attention from mainstream media and not just financial outlets. Central banks are known as the lenders of last resorts and so they simply cannot lose money. Japan's core consumer prices in December rose 4.0% from a year earlier, double the central bank's 2% target, hitting a fresh 41-year high and keeping alive market expectations the central bank could phase out ultra-low interest rates. Mr. Kurodo recently took a pass on making a decision his successor we feel will not be able to ignore. Whether Mr. Powell at the Fed ignores the totality of the Japanese monetary experience remains to be seen, we just hope that any physical actions on the part of the Fed are done with skill while taking into consideration the moral aspect of what such actions might result in also.

Britain's *actual* King…

Rishi Sunak is rich, *really* rich. British stocks? More on that in a moment…

For now, let's get to know Britain's *actual* King a bit more closely. Rishi Sunak is just 42 years old. Sunak's father was a Physician, and his mother was a Pharmacist. The elder Sunak's clearly made education a top priority at their house, and the dividends have been ringing in ever since. Rishi was a star in preparatory school, a Fulbright scholar in business school (Stanford) and he went on to enjoy predictably successful careers at Goldman Sachs and as a Hedge Fund Manager. On paper alone, Sunak was a shoo-in to become Chancellor of the Exchequer, which he did. But the Prime Minister's office? That was a whole other kettle of fish. Let's recall that in a race to win the Conservative Party Leadership last year, Sunak didn't exactly annihilate Liz Truss. Truss polled 81,326 votes, compared to Sunak's 60,399 in an election with broad turnout of over 80%, with 654 rejected ballots from a total of 172,437 eligible Tory voters. Truss won by a comfortable margin, but her victory was slimmer than in other recent Tory leadership contests at 57.4 per cent to Sunak's 42.6 per cent – reflecting a divide within the governing party. It was only after Truss got the keys to Downing Street that things pretty much fell apart for her and Sunak got his big break. But as sterling as Sunak's credentials are, what does a man like Rishi Sunak have in common with the average Brit?

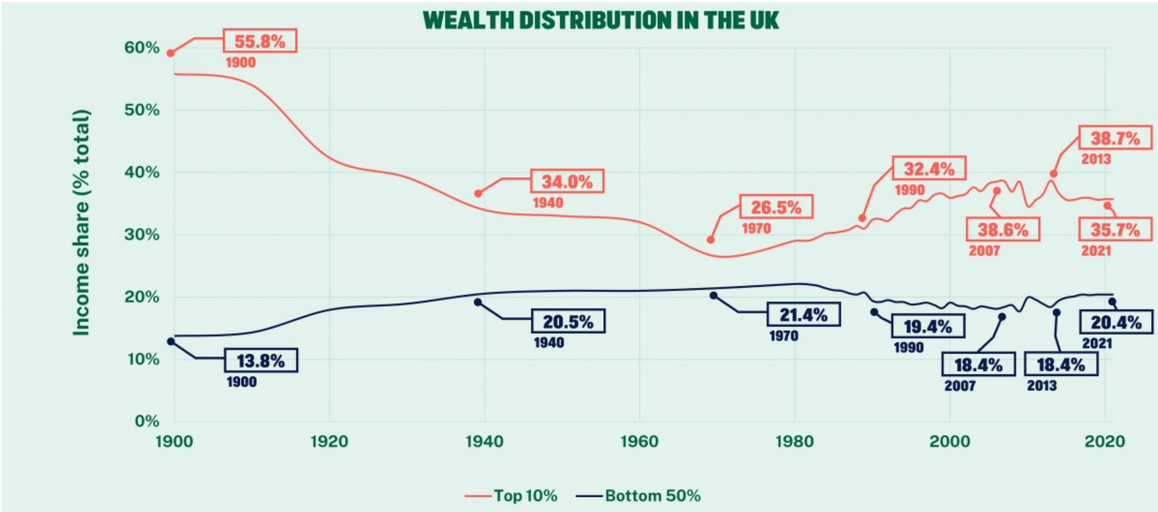
I mentioned that Sunak is rich, *really* rich and that might prompt you to ask *how* rich is *really* rich? It's a fair question and I have a thoroughly researched answer. On any given day, Sunak's net worth stands within a few pence of a billion dollars. His bank accounts make him richer than Britain's *other* King, you know: Will and "Hellraiser" Harry's dad. In fact, Sunak's bank accounts make him twice as rich as King Charles. Sunak also has a thing for real estate. For starters, there's his official work address:

And then there is Sunak's budding portfolio of personal properties, the quaternary property (no typo) is displayed below for either your viewing pleasure or envy, and I don't think the term castle would look out of place in its description…

For good measures, Sunak married rich too…really rich. His wife, Akshata Murty, is the daughter of Infosys Limited (one of India's biggest IT companies) and Murty has a wall full of degrees too. But for all Sunak's wealth and power, is he really the sort of individual that understands what the average citizen of the United Kingdom is going through these days? Clearly, the stock market seems to think so.

However, unlike Mr. and Mrs. Sunak, the United Kingdom as a whole is facing some more pedestrian economic growth forecasts. The IMF expects Britain's economy to *contract* by 0.6% this year, after having previously forecasted moderate growth. Indeed the UK might very well surprise to the upside, but cost-of-living pressures that are pushing the Kingdom's economically vulnerable into crisis and intensely squeezing the budgets of middle-income households. High exposure to natural gas prices being passed on to consumers coupled with sluggish employment that remains below pre-pandemic level despite a very tight labor market. But more investor money has never been pumped into British stocks. Just this week the FTSE hit an all-time high of 7,940 points on the heals of higher profits at Standard Charter a bank beefed up by higher interest rates and energy giant British Petroleum (BP).

But British stocks are not about the domestic economy. The majority of FTSE 100 company revenues are derived from overseas. A softer sterling also helped support more regal corporate profits once mostly American dollar denominated revenues from overseas were tabulated back in London. And let's also not forget that the UK is home to a good number of defensive names such as Staples, Unilever and AstraZeneca. Consumer products and healthcare companies have done very well recently not only because of COVID but because of the volatility and higher debt cost burden that these days plagues smaller companies. But even as investors seemingly cannot get enough of British stocks, crusaders fighting for the nation's lower income earnings continue their calls on Rishi Sunak and his government to extend accommodations for things like higher food and energy bills. So, making ends meet will prove to be a challenge. Another, longer-term challenge, concerns the distribution of wealth in the UK Assets in Britain are even more unequally distributed than income. According to the Wealth Inequality Report, the richest 10% of Brits held 43% of the nation's wealth. More soberingly but hardly surprising is that British "one percenters" have seen their share of total wealth double since the early 1980s.



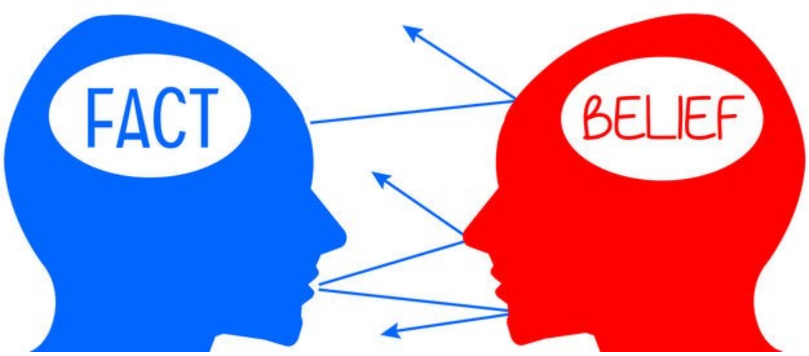
[The Wealth Inequality Report tracks the distribution of wealth (i.e. real and financial assets) in the UK and other countries. Perhaps the word distribution should be replaced with the word concentration as more and more is owned by fewer and fewer.]

So does uncertainty about the plight of the average British citizen make us feel investors should worry about British stocks? For the time being no. Confidence on the part of corporate executives seems high: FTSE 100 companies announced a record of well over 50 billion pounds in share buybacks during 2022 along with nearly 3 billion pounds of "special" dividends paid. Analysts forecast 2023 to be a royal one for dividends in the UK with the glaring omission being that very few lower income Brits own stocks. However, aggregate earnings forecasts for British companies in 2023 could very well be too high, especially if a recession of any greater depth or persistence surfaces. The FTSE 100 is ahead of analysts in terms of pricing that is despite its resilience in what is a deeply mixed economic picture.

Rishi Sunak might not be Britain's true King. However, the "King's Ransom" that is his own net worth depends on strength in the stock market, real estate prices and private investment. And though he is undoubtably one of the U. K's best and brightest, he has tasted defeat before at the hands of Liz Truss. Sunak's legacy as Prime Minister will be defined by carefully orchestrating a plan that fashions together what is good not just for some Brits, but all Brits…and that does not get taught at business school.

Behavioral Investing: Facts and beliefs

On Tuesday January 31st, 2023, at 2:31pm EST I snapped this ↑ picture of a luxury home being built in Miami, Florida. I am sure the question you are now asking yourself is: “Why didn’t you snap pictures of a *completed* luxury home in Miami, Florida”? I want to reassure you: I did that too. But when you are making investments, you want to reassure yourself that things are going according to plan. Financial models we use to inoculate incoming data coming from projects like that house are one thing, but they represent an academic exercise of number crunching.



Physical tours help to more than just link together a financial statement or spreadsheet to a building that will help investors realize their return objectives. Physical tours help establish help one reconcile fact and belief. Belief is a powerful emotion that governs a wide range of outcomes relating to our hopes, relationships and even investment strategies. You believe that working out regularly and eating a healthy diet will lead to a leaner, healthier you. Many things one believes are the result of a pattern the sun always seems to rise in the east and sets in the west, and therefore will continue to do so.

But in some cases, you believe things despite logic and evidence to the contrary: the next penny stock I buy will go to the moon or this really and truly is the next Microsoft, Amazon or Google I am sitting on. Belief is like that; some things you believe because you just do. Paul Zak, a neuroscientist at Claremont Graduate University mentions that irrational convictions are common in even the brightest of people. 2-time Nobel Prize winner Linus Pauling for example believed that vitamin C was a magic elixir that could cure-all for things despite a basic lack of scientific evidence supporting his belief. At MacNicol and Associates we make thoroughly researched investment decisions for you and your family in good faith, which is to say we have to trust the people we do business with. We certainly believe we are making good choices for you and a variety of internal and external processes help us distill fact from fiction. So did I go a little overboard when I snapped that picture? Literally and figuratively my answer is no. Think of it this way, you can snap pictures of a million different things with your cell phone camera. I simply opted to use my cell phone camera to confirm my beliefs and make me more confident in the investments we make for you.

The MacNicol Investment Team