MACNICOL & ASSOCIATES ASSET MANAGEMENT INC.

May 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.

"And so with the sunshine and the great bursts of leaves growing on the trees, just as things grow in fast movies, I had that familiar conviction that life was beginning over again with the summer."

- F. Scott Fitzgerald, *The Great Gatsby*

The Numbers:

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Index:		**2023 YTD:**
S&P/TSX:		6.5%
NASDAQ:		16.8%
Dow Jones:		2.9%
S&P500:		8.6%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	4.44%	5.20%
5-Year Bond:	3.00%	3.36%
10-Year Bond:	2.83%	3.39%
30-Year Bond:	2.98%	3.74%

Economic Data:

- First Republic Bank fails
- Drought in Argentina pressures the peso
- US Federal Reserve raises interest rates by a quarter of one percent to 5.00-5.25%
- Crude oil lower in April
- Gold bullion stable in April at $1,969/Oz
- Chinese bond market signals ongoing challenges despite relaxed COVID and property policies
- US Q1'23 GDP positive at 1.1%

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	22	21
P/B: Price-to-Book	4.1	4.5
P/S: Price-to-Sales	2.4	2.8
Yield: Dividend Yield	1.7%	1.4%

2023 Year to Date Performance, by Sector: April 30th, 2023

S&P/TSX Composite	6.5%
NASDAQ	16.8%
Dow Jones Industrials	2.9%
S&P 500	8.6%
Russel 2000 (Small Caps)	0.4%
MSCI EAFE	10.3%
Crude Oil Spot (WTI)	-4.3%
Gold Bullion ($US/Troy Ounce)	9.6%
SOX Semiconductor Index	18.9%
VIX Volatility Index	-11.7%

Source: Canaccord Genuity Capital Markets & Thomson Reuters

Foreign Exchange - FX

As of May 15, 2023 07:00 AM EST	$5,000	Cdn		
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.355	$3,690	$1	0.0%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.3850	$3,610	$(79)	-2.2%
Raymond James	1.3557	$3,688	$(1)	0.0%
Royal Bank	1.3833	$3,615	$(74)	-2.1%
Scotia	1.3893	$3,599	$(90)	-2.5%
TD	1.3912	$3,594	$(95)	-2.6%
Canadian Snowbird	1.3648	$3,664	$(25)	-0.7%
Spot Rate	1.3555	$3,689	$-	0.0%

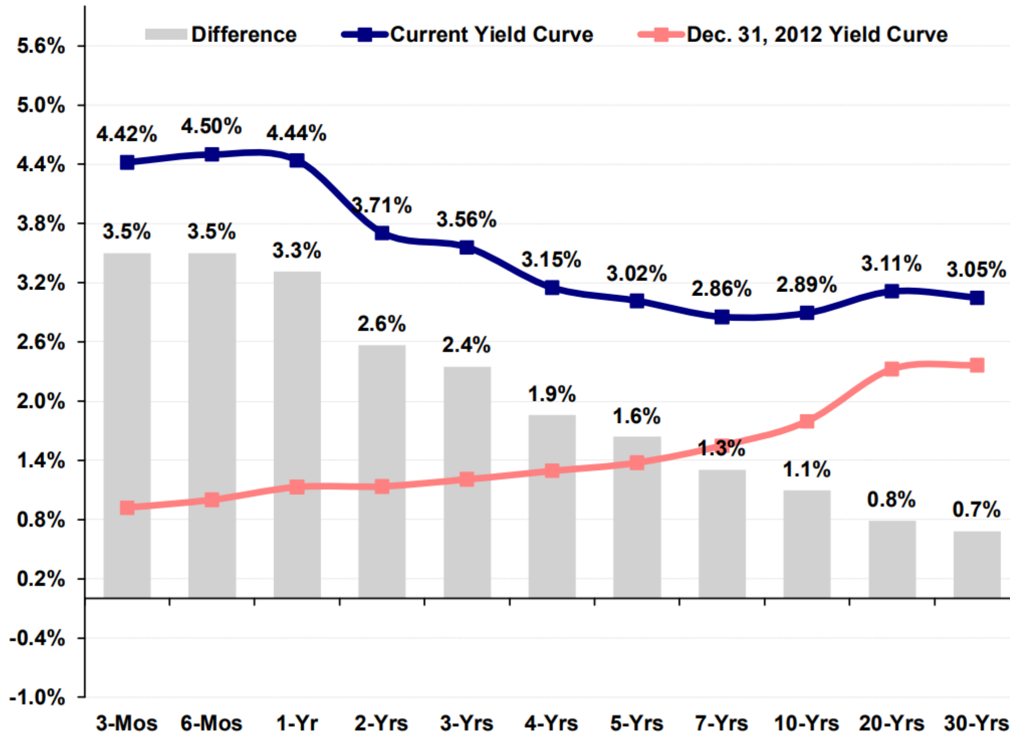
Sell in May and you will *pay*…

Over the past twenty years I have developed a reputation for making prudent investment decisions for clients at inopportune times. While certainly not something to broadcast in my line of work, I suppose it is far better than making horrendous investment decisions at any time. As most of you are not professional investors, questions as to an investment's underlying quality are usually deferred to us and we appreciate your trust. But as to the question of whether to invest in the first place or not, well, that one is more nuanced because it introduces an element of timing. In this seemingly crazier and crazier world, it *never* seems like a good time to invest. Heads, the economy *may* be headed for a recession and financial markets will weaken. Tails, the economy *is* headed for or perhaps already in a recession and financial markets will weaken dramatically. Which will it be and more importantly should you really "head for the hills" now? Let's find out…

To get us going, I have attached a chart of the S&P500 above. The chart comes courtesy of technical analyst Andrew Adams, and it shows that stocks have mostly agreed with numerous economists who have suggested that

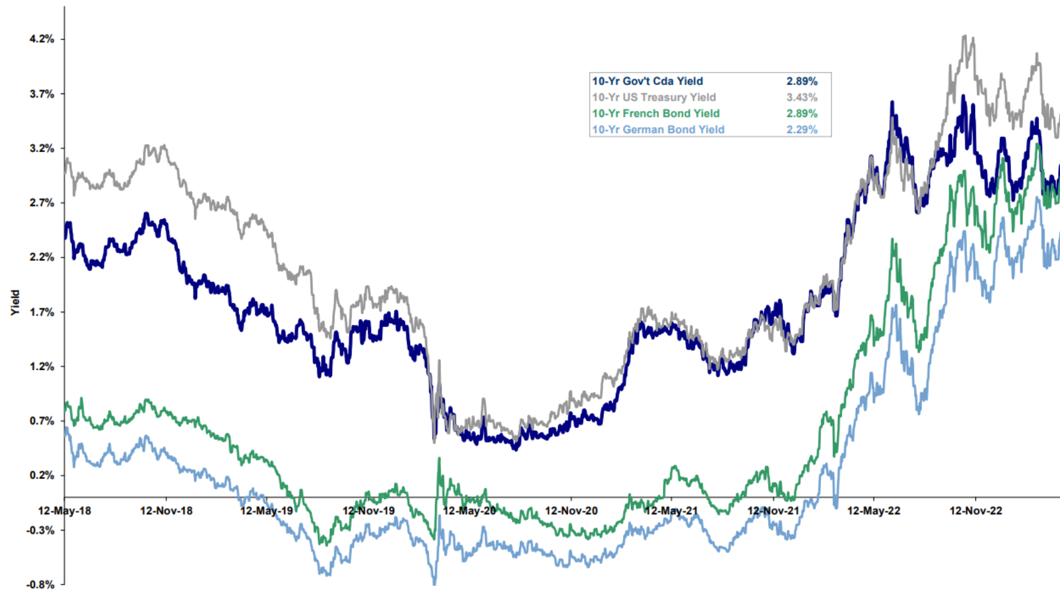
a recession was either already underway or just around the corner.

Next up, the bond market, which concurs with the assessment of stocks that the economy just isn't as robust and vigorous as it once was (the navy-blue line).



Those are two very powerful market-based indicators of economic health which support the thesis that the economy is either in a recession or the thesis that the economy will soon be in a recession. Yet four months into 2023, the MacNicol Investment Team is **cautiously optimistic**. Could a recession unfold prior to the end of this year or at some point in 2024? Of course, it certainly could, but it is an eventuality not a certainty. What's more, we continue to believe that investors can make money if they simply choose to look at things a little differently. To assuage the notion that we are already in a recession we invite you to examine recently released US real GDP figures, which despite being lower were still positive. In an environment where investment newsletters of the spookiest sort are selling you fear on a daily basis, the biggest economy in the entire world still managed to squeak out a gain.

Political brinkmanship around the U.S. debt ceiling will function as further fodder for fear mongers so expect more YouTube videos with scary music, dark lighting and close up shots of the Eye of Providence (the creepy eyeball that floats over the pyramids on the back of the US dollar) from well-known alarmists like Peter Schiff, Jim Rickards and Harry "the biggest crash ever is coming" Dent. Although they are wildly entertaining in the same way that professional wrestling is (i.e. fake) do not allow "shockvertising" to derail you or your family's savings. In no way do any of us here at MacNicol seriously believe that the technical problem associated with a debt ceiling impasse (an outcome where the US Treasury will not have sufficient funds to pay the government's bills) will actually happen. Mr. Biden will likely have to table a modest policy concession to Republicans, which may not relate to the budget, and the political pressure to strike a deal will in general be enormous. After all who really wants to be on the hook for cheques not going out. Fortunately, all the drama over the debt ceiling has helped us to take the edge of higher interest rates.



[Data from Refinitiv shows that while rates globally are still very much at elevated levels, they are for the time being very much off the highs.]

With peak inflation and peak rates in the rearview mirror, investors that have yet to commit to an investment program should get off the fence. An outcome like this is something consumers and businesses want, and something central banks had hoped for. Fortune favors the bold, but it also favors those who are paying attention to something *other than* fear tactics or whatever the prevailing economic crisis happens to be featured on the 6 o'clock news. Opportunity is knocking and so may we recommend something the next time you get bombarded by a brazen band of bears:

Buy in June reap the rewards soon…

For investors paranoid about making the decision to invest, or concerned by the seemingly endless supply of doomsday prophecies going around, one final point. Historically speaking, being bullish on stocks *after* a negative year has paid off more often than not, and Canadian equities are a standout in this department. The S&P/TSX has only *ever* had two consecutive negative years (2001, 2002) during the Dot.com bubble burst. Remember, Canadian equities have *never* lost money for more than 2 calendar years. In the United States, the S&P500 is no slouch either. There have only been five occasions when US stocks fell in multiple calendar years: the depression (1929, 1930, 1931 and 1932), the initial years of World War II (1939, 1940 and 1941) the collapse of Bretton Woods and "Nixon Era" (1969, 1970), the stagflation era of the 1970s (1973, 1974) and the very same Dot.com bubble burst felt in Toronto (2001, 2002). Even in appalling conditions, stocks rarely experience multiple negative years in a row, and when they do the rebounds are that much more profitable.

Financial markets can continue to climb a wall of worry, but you don't have to. Speak with us today about deploying new capital or more capital. Remember, no one has ever redeemed their way to prosperity.

No, they won't *all* be repurposed into condos…

Roughly 3 hours prior to penning this next piece for you, I had participated in a review meeting with one of our investors in Western Canada. The concern raised by that party (a good one) centered around large, expensive, and mostly empty commercial office towers. I advised that in the nearly six years that I have been at the helm of our private real estate program, I have not once added to our position in commercial office space. For greater context, certain investments made over the past 6 years have certainly caused me to tinker with real estate pie charts and a perfect example is a distribution asset we own in Greensboro, NC. 300 Penny Road is tenanted by home renovation titan Lowes. The vacancy rate at 300 Penny is 0%, the rent collection rate is 100% and I know all this due to the tiny section of office space straddled across the front façade of the building. A driveway out front, truck ports in the back, 150,000 square feet of money-making in the middle along with a tiny office keeping track of it all. Thus 300 Penny Road is a far cry from the vacant behemoths that represent the skylines of most major cities.

As you will imagine, this made our client feel a lot better. But it led to an equally important follow-up question which was should *existing* investors in commercial office space head to the elevators or better yet the emergency staircases? Well, a decade ago, a company by the name of Alder Hill Management, one of the top players in the commercial mortgage-backed securities space made the determination that malls were a thing of the past and destined to be annihilated by retail kingpin Amazon. Alder Hill began *shorting* CMBX, the commercial mortgage market's version of the S&P 500 on the expectation that mall owners would not be able to make payments on their loans. While many malls did indeed implode, their deaths took (much) longer than Alder Hill reckoned it would. What's more, in or around 2021, some malls began to report something not seen in some time: shoppers. That's when Alder Hill's short position in CMBX indexes went from bad to worse. After maintaining the money losing trade well past their eviction notice, Alder Hill called it quits and closed its biggest mortgage-backed securities fund. Had Alder Hill been able to maintain the trade for just a little while longer, who knows, perhaps the fund would have been gushing profits.

Today many investors list commercial office space as the existential crisis in real estate, and for good reason. Occupancy statistics for the CBDs (Central Business Districts) of most TSX listed office REITs are atrocious. And in many submarkets, even good ones, hardly a day goes by without news of an office building in default or lenders who are unable (or unwilling) to refinance debt. And one of real estate's Achilles heels has always been the sector's tendency to extend and pretend problems for another or even another month or quarter. But the tricky technical aspects of office leasing velocity make leaving precarious and a decision to be made long before loan-to-value ratios or maturity dates come into play.

So timing is everything, show up too early and capital will be left vacant. Show up too late, and you need an apocalypse to get paid.

[Our offices aren't *faulty* they are strategic, active and there for a purpose.]

But there are those who believe that offices can grind this out. Malls and shopping centers often have co-tenancy clauses that allow smaller tenants to split if an anchor tenant leaves, exacerbating a property's failure. Offices do not typically have those kinds of agreements, and if Lowes vacated 300 Penny, then they would obviously have no need for the asset's office space either. With staggered 10-year leases, it can take a long time for changes in work patterns to affect property values. Carl Icahn recently undertook legal action against Rialto Capital, alleging the special servicer had dragged its feet on the sale of a foreclosed outlet mall near Las Vegas. Icahn claimed Rialto was pressured to do so by mutual fund manager Putnam Investments, which was on the long side of the mall trade and stood to benefit from any delays in selling. Icahn's legal team likened it to an insurance provider pressuring a doctor to declare a sick patient healthy. Ichan obviously wanted for devaluations to be realized faster. Even if you have the fundamentals figured out (no workers in the coffee room and tons of parking spots) the technical intricacies of taking liberties with office space can be treacherous.

Not all offices are empty and not all of them will become condos in 5 years. Crowded trades and cranky executives with "show up **to** work or else" policies like Jamie Dimon (JP Morgan) and Elon Musk (Tesla) mean that while we haven't added to office in a major way we aren't about to climb Alder Hill. Besides, there is nothing *Fawlty* about our towers.

You gotta know when to fold em…

I recently took a trip to Las Vegas to enjoy some good ole fashioned desert heat. I am not a fan of the other things on offer in Vegas but singeing my bald head in 90-degree heat is just what the Doctor ordered. And I have always been very impressed with Vegas' abilities to separate you from your wallet. I know of no other city where you can easily blow $2,000/day…frankly…Vegas makes behaving parsimoniously impossible and throwing frugality by the wayside was fun, liberating and yes expensive.

Fun and exciting as it might be, gambling is rarely profitable. It can also be dangerous and highly addictive. The best way to protect yourself and your capital from the dangers of gambling is by playing country music legend Kenny Rogers' song *The Gambler* before you begin. Released in November of 1978, *The Gambler* is mostly a song about dealing with relationships through the perspective of a seat at a Blackjack table. *The Gambler* has very clear parallels to investing. Knowing when to "*fold em*" is key in any successful investment campaign but the activity involves understanding more about what you might learn in a psychology class than a business school. Many of the world's top blackjack players will tell you that the secret to their success is **knowing when to cut your losses** and though they are doubtlessly good at numbers, elite gamblers are arguably better at understanding emotions.

Loss Aversion

Investors hate triggering losses approximately 2-3 times as much as they enjoy harnessing equivalent sized gains. Empirical evidence around loss aversion can be found in volumes through a quick Google search, and a range of authors from the worlds of business, neuroscience and psychology have covered this topic over the years. So, what I thought might be helpful is devising a strategy for dealing with loss aversion that you can actually use: at the Blackjack table or the boardroom. Since we know that loss aversion is more difficult to deal with, I want each of you to think of yourselves as entrepreneurs. No serious business owner would ever continue to funnel resources to a money losing business venture, that would just be crazy.

COGNITIVE
BIAS

Next, I'd like you to think of yourself as a professional entertainer. As an entertainer, you know you have a certain minimum cost associated with taking your show to cities or towns all over the world, so you'll want to ensure you play in big arenas where the odds of a sold-out show are in your favour. Lastly, and I appreciate that this might be a sensitive topic, I want you to think of yourself as the head coach for a professional sports team. At your disposal are many of the game's top athletes, each with their own quirks, features, and abilities. As head coach, you always want to ensure you have the very best crew in action come game time. Yes, it can be difficult pulling the plug on a business venture, a town that you really would like to play for sentimental reasons or benching an elite athlete going through a slump…but just like unloading an underperforming investment…these are decisions you have to make.

At MacNicol & Associates Asset Management, we certainly understand that investments go through ups and downs, that's just the natural ebb and flow of the capital markets. Our over 20 years of investment experience working for you that we are also subject to behavioral investing biases and so long ago, we established a formal sales criterion to prevent even ourselves from "falling in love" with a given position. The sell criteria you'll find below are from our official company presentation deck and it is more than simply a promotional slide: it is something we review for clients on a regular basis.

Sell Criteria

- Excessive valuation.
- Size of holding exceeds parameter.
- Loss of confidence in management.
- More attractive opportunities elsewhere.

If it sometimes feels like the stock market is a giant casino, there is a very good reason for that: it can. But it doesn't have to. Markets can be irrational, but you don't have to be. If you or someone you know is struggling with long good-byes, have them speak to us. We offer comprehensive, no obligation portfolio reviews that judge the underlying investments not you.

The MacNicol Investment Team

Firm Wide News

David and Diane MacNicol are thrilled to announce that their oldest son, David got engaged a week ago and will be getting married in two weeks in their backyard. It will be a small, family only wedding and they couldn't be more excited.

David and Megan will be moving to Orlando in June where David will begin his residency in family medicine.

Their daughter Sarah is also engaged and getting married in September. A busy year!