

February 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 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.

*“An experiment is a question science poses to Nature, and a measurement is a recording of Nature’s answer”*

- Max Planck, Nobel Prize winning Physicist “father” of Quantum Theory

The Numbers:

<u>Index:</u>	<u>2022 YTD:</u>	
S&P/TSX:		- 0.59%
NASDAQ:		- 8.9%
Dow Jones:		- 3.3%
S&P500:		- 5.3%
<u>Interest Rates:</u>	<u>Canada</u>	<u>USA</u>
90-Day T-Bill:	0.28%	0.24%
5-Year Bond:	1.70%	1.79%
10-Year Bond:	1.86%	1.94%
30-Year Bond:	2.11%	2.24%
<u>Economic Data:</u>		
<ul style="list-style-type: none"> <li>• Canada lost 200,000 jobs in January</li> <li>• US added 467,000 jobs in January</li> <li>• Oil higher by 18% YTD in 2022 to \$88</li> <li>• Natural gas up by 37% in YTD in 2022</li> <li>• Stocks globally lower in January</li> <li>• Geopolitical risk elevated on Russian movements near Ukraine</li> <li>• Gold rebounding in late January though still off from its \$1,852/oz. high</li> <li>• Digital currencies fall sharply in mid-January</li> </ul>		

### Valuation Measures: S&P 500 Index

<u>Valuation Measure</u>	<u>Latest</u>	<u>1-year ago</u>
P/E: Price-to-Earnings	26	33
P/B: Price-to-Book	4.6	4.1
P/S: Price-to-Sales	3.0	2.8
Yield: Dividend Yield	1.3%	1.5%

### 2021 Calendar Year Performance, by Sector: Jan 31<sup>st</sup>, 2022

S&P/TSX Composite	-0.59%
NASDAQ	-8.9%
Dow Jones Industrials	-3.3%
S&P 500	-5.3%
Russel 2000 (Small Caps)	-9.66%
MSCI ACWI ex-USA	-2.55%
Crude Oil Spot (WTI)	18%
Gold Bullion (\$US/Troy Ounce)	-1.9%
SOX Semi-conductor Index	-11.6%
VIX Volatility Index	14.0%
Source: Canaccord Genuity Capital Markets & Thomson Reuters	

## **Foreign Exchange - FX**

As of Feb 11, 2022 1:00 PM	\$5,000	Cdn		
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.2671	\$3,946	\$0	0.0%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.2797	\$3,907	\$(39)	-1.0%
Raymond James	1.2853	\$3,890	\$(56)	-1.4%
Royal Bank	1.2941	\$3,864	\$(82)	-2.1%
Scotia	1.3053	\$3,831	\$(115)	-3.0%
TD	1.3027	\$3,838	\$(108)	-2.8%
Canadian Snowbird	1.2804	\$3,905	\$(41)	-1.0%
Spot Rate	1.2672	\$3,946	\$-	0.0%

### **A little clarity on fiscal austerity...**

A little over 20 years ago, I attended an MBA information session at the University of Toronto's Rotman School of Management. I was a U of T undergraduate student at the time, and my college happened to be next to the Rotman building. The Professor doing the talking that evening was excellent, a truly great ambassador of the school though for the life I me I cannot remember his full name. "Paul" looked like a business school professor: part Einstein archetype and part successful venture capitalist, Paul spoke well and spoke with intention, and I suppose he should. The U of T sometimes gets labelled as "The Harvard of the North", which I appreciate but never fully accepted. For one thing, Harvard's official geographic location is 42.3770° N, 71.1167° W whereas the U of T is located at 43.6609° N, 79.3960° W. One degree of longitudinal rotation is only 60 miles, and you will have a tough time convincing anyone from Boston that Toronto's winters are colder.

I have always felt that Harvard will always be Harvard because its Harvard. And "Paul" seemed to concur. During the Q&A session, one prospective student asked: "*What should I do if I get into Harvard Business School too*"? To which "Paul" replied: "*You should go there...it's a fantastic school*". U of T, Harvard...they're both great schools. And in theory, you should go to the one that best suits your higher learning needs. But reality can be more nuanced than theory. Nuanced and fluid, which is to say changing. Scientists such as Max Planck unearth laws about nature that are – for the most part – permanent and just as true today as they will be in a thousand years. In Planck's case, work done subsequent to his, did not render quantum mechanics unnecessary. Rather, it accentuated the enduring and central importance of quantum theory. But what about in the world of social sciences, like economics?

### **Well, things can change...**

Larry Summers reckons the big thing changing in the world of economics is real yields, and deficits. Now real yields obviously change daily so it isn't the yields themselves changing that is the issue. Instead, how economists understand real yields and the real economy is changing in a way that suggests that larger fiscal deficits may-be appropriate when one obtains a clearer view of what fiscal austerity even means.

In the world of finance, the word austerity means a set of political-economic policies that reduce government budget deficits through spending cuts, tax increases, or a combination of both. In recent essays and interviews, Summers is a lot clearer about his views on fiscal stimulus.



Summers believes the \$1.9 trillion Biden stimulus plan is something the economy simply did not need. With several indicators of a robust economy only temporarily set back by COVID and supply chain disruptions, the Biden plan poured fuel on an already fiery economy. Among the clearest indications of economic vigor were the degree of vacancies to unemployment, which are at unprecedented levels. Workers are *leaving* jobs at record rates because of higher paying, better quality job opportunities elsewhere, and layoffs are extraordinarily low. In many industries like financial services, medicine, the restaurant industry, and farming labor shortages exists, and employers cannot find enough able bodies to meet their needs. Labor is in short supply, putting upward pressure on wages and the inflation process.



[A Financial Advisor I know in Ottawa is hiring staff. If you know anyone, let me know.]

The inflation challenge is magnified by a variety of supply-chain bottlenecks ranging from the availability of circuit boards for new vehicles to the barely and hops used in some categories of designer beer, as well as issues with finding cans the beer is packaged in.

The strong demand and limited supply situation that has developed over the last year is inflationary and we suggest that the pandemic front loaded many existing trends in the economy by at least 5 years and this includes inflation driven mainly by monetary policy that was too loose for too long. But would inflation have been a problem had the pandemic never occurred? Most likely yes. We think yes, but fiscal stimulus was also super-sized when it ought not have been, and terms such as “transitory” and “target range” were replaced by terms like “we are on a path to higher rates” and “we need to drop the term transitory”. Without the overwhelming stimulus that was applied (well into recovery) prices had no choice but to rise and supply problems made it a small wonder that inflation has risen to 7 percent.

### **Ease to appease.**

Not that simple. As the pandemic becomes endemic, conditions around restrictions will ease. More people will be able to go back to work, and more goods will begin to flow to consumers and businesses, but don’t expect the pandemic ending to end inflation. Inflation is the main economic problem experienced by many people in the developed world and it is contributing to social unrest.



**[One thing politicians can do is aid a country that is pessimistic about it’s future. But to do that, they need to be present and willing to take a stand on contentious issues.]**

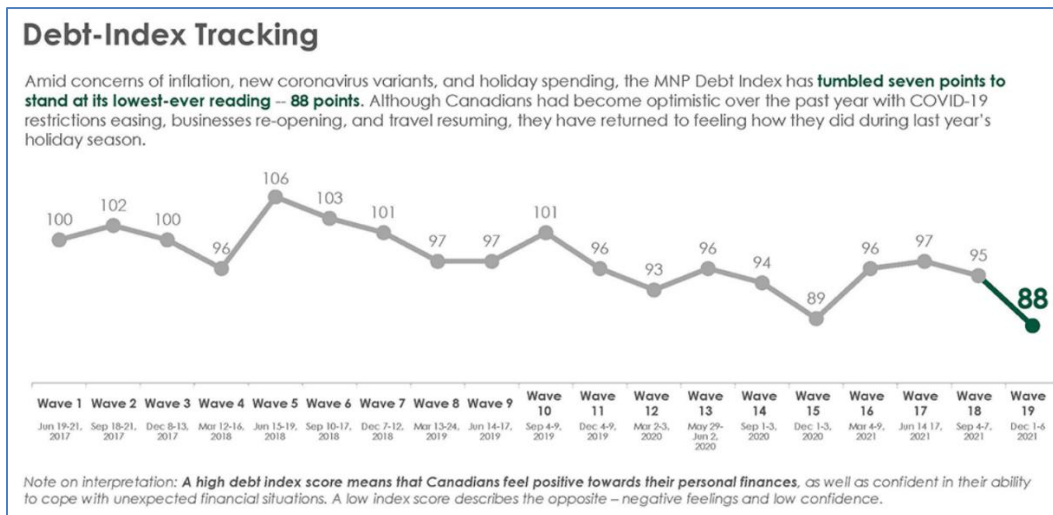
Social unrest in turn leads to pessimism about the future, which weakens democratic institutions are being challenged. If my wages rise by 20% percent and the cost of my favorite summertime ale goes up by 20%, then I am in the same place in terms of purchasing power as I was before the increase in both factors. But that doesn’t change the fact that I am still grumpy over my rising cost of beer. You see I am likely to credit myself for the 20% increase in my wages but criticize political process for 20% increase in refreshing myself over the weekend.

### **A path to trouble...**

Tiff Macklem has many Canadians believing that interest rate rises are coming in droves. Of course, we aren’t quite sure that will happen. Rates are surely biased upwards, but that is by no means a sign that rate hikes this year are axiomatic. Canada has some issues brewing starting with the basic fact that our country isn’t all that confident in its own finances.



Accounting firm MNP tracks debt levels and insolvencies in Canada and their latest results show that Canadians feel extremely negative about their personal finances and unsure about their ability to cope with unexpected financial situations.

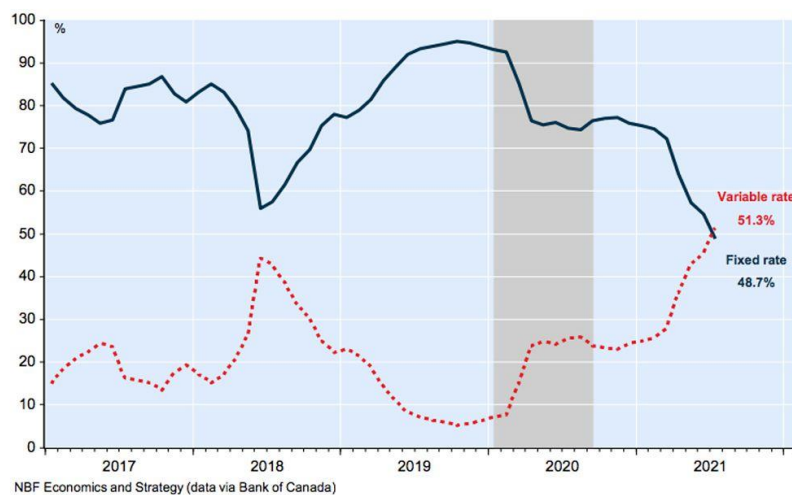


[I'm not so sure this is the best time to raise interest rates in Canada. Thankfully, I am not the head of our nation's central bank.]

Homebuyers who go with variable over fixed increase their buying power by 9% for the same monthly payment but might risk staying in debt for years longer. The fixed nature of a variable rate mortgage simply means the bank who lent you the money keeps getting paid while your balance remains the same.

### Canada: Variable rate mortgages have never been more popular

Proportion of new residential mortgage made by banks, fixed rate and variable rate loans



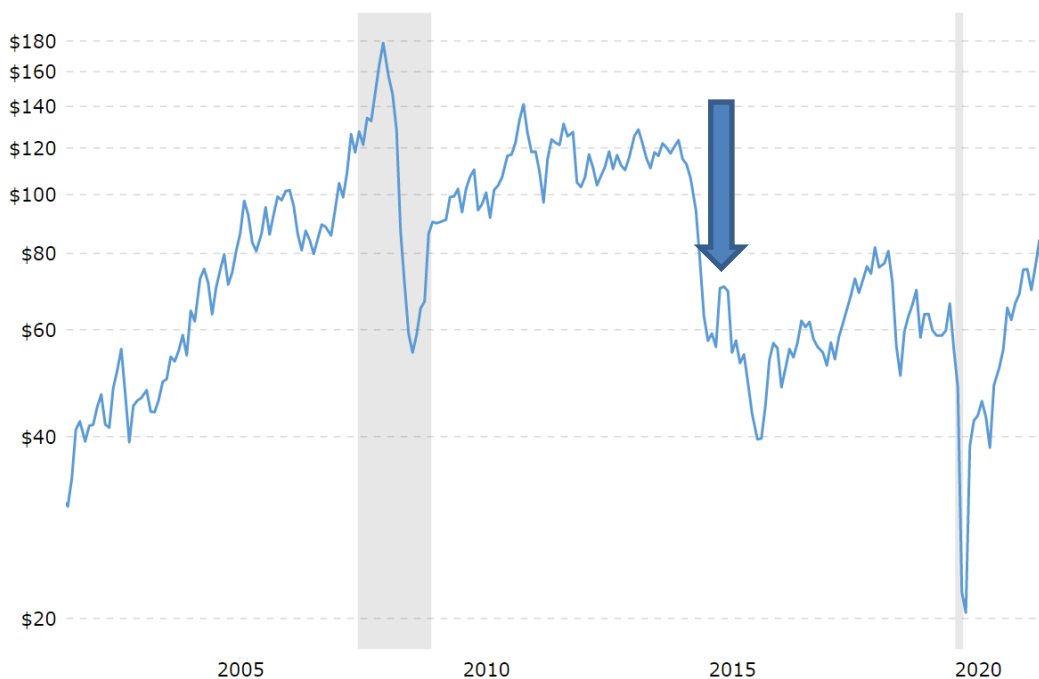
[Variable rate mortgages were selling like “hot cakes” past the midway point of 2021. In July of 2021 more than half of all originations and refinancing were variable. One reason for this was the widening spread between fixed and variable rates. A 5-year term in July of 2021, carried a 79-basis point spread in favor of variable rates, the highest since June 2018. HELOCs tied to variable rates however leave people more vulnerable in the day-to-day because half of all new variable rate mortgages have fixed payments. Meaning that as interest rates rise, borrowers still make the same mortgage payment, but the repayment of capital goes down. People will be paying for years.]

You don't fight fire with fire in economics you fight fire with water. A sobering dose of economic reality is all Larry Summers is suggesting in his recent work. Too much stimulus particularly when unnecessary will balloon out deficits and make real yields dismal for years and along with it the general psyche of citizens and businesses. Fiscal austerity isn't always clear, but in this case, we cannot help but say that less really is more.

## The MacNicol Investment Team

### More of a trickle, less of a gusher...

One of the most lopsided beatings I received in my entire life came at the hands of Shihan<sup>1</sup> Bill Carr, an old Scottish karate instructor of mine from the early 2000s. You might not associate karate with Scotland but let me assure you that Bill could make even well-trained students look pretty foolish after only a few seconds. His excellent teaching skills and old-school "toughness" made Bill's classes what all karate classes should be: engaging, challenging, and rewarding. But if you never tried karate before you'd be forgiven for thinking about the sport as fast paced. Karate is *best* described as more of a marathon and less of a sprint. The stuff you learn gets "trickled" down to you slowly with more coming only after mastery of what you were taught first. Aside from a few exceptional cases like Chuck Norris, most karate students aren't "gushing" with knowledge or winning championships in years 1 or 2 of their journey. Crude oil and the companies who explore, refine, or sell it are in my mind quite similar to karate. Both frenetic to the untrained eye, and both capable of exacting a painful lesson on the ignorant. But life's lessons aren't always failures, especially if you learn something from them. In the case of karate, I learned that one's physical appearance matters little and that there are people in this world whose knowledge of karate should never be underestimated. In the case of crude oil, I learned never to underestimate OPEC on the downside and never to overestimate OPEC on the upside.



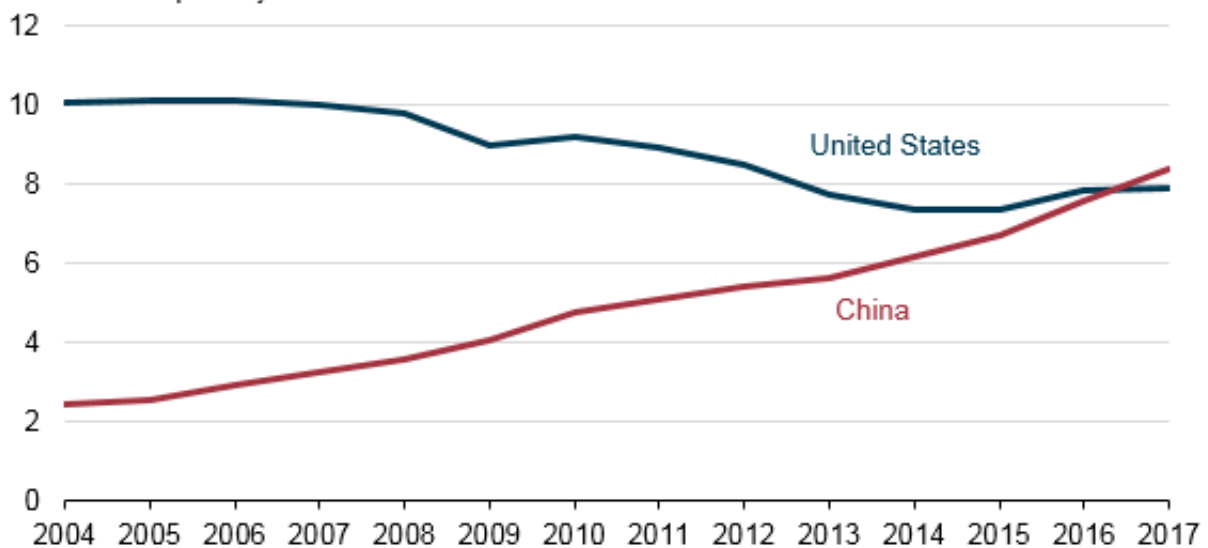
[This 20-year graph of West Texas Intermediate outlines my working career, and my ill-timed binge on oil stocks.]

<sup>1</sup> In Karate, Shihan is the rank of Master

Like many investors, I watched the price of West Texas Intermediate (WTI) plunge during the fourth quarter of 2014 when OPEC decided to apply some pressure to producers in North America. OPEC did not want American's energy self-sufficient, nor did they want energy executives in Calgary growing richer by the quarter. Mainly what OPEC wanted was to regain control. Even within the cartel itself exist deep divisions which show the degree to which OPEC will go to assert control. In 1977, Riyadh voted *against* holding supply at bay seemingly on purpose to plunder Iran's already vulnerable economy into an economic abyss.

**Annual U.S. and China gross crude oil imports (2004-2017)**

million barrels per day



[China has been a growing client of OPECs for years. In mid-2016, the Chinese replaced the Americans as OPECs top customer.]

OPEC picked a similarly good time to disrupt energy markets in late 2014. China was rapidly becoming the cartel's largest customer and back up in Calgary, oil executives outnumbered bank executives. That's when I moved in for "the kill", or so I thought. Oil markets resumed their downward nosedive all the way until the second half of 2015. Oil did not bottom out until well into 2016 and it was too late for most companies [CAPEX was slashed, workers were let go and dividends were cut] and too late for me [the stock prices of many of the companies I had bought imploded]. Though oil eventually rallied, it was four full *years* before my energy trades broke even.

### So, what is OPEC up to these days?

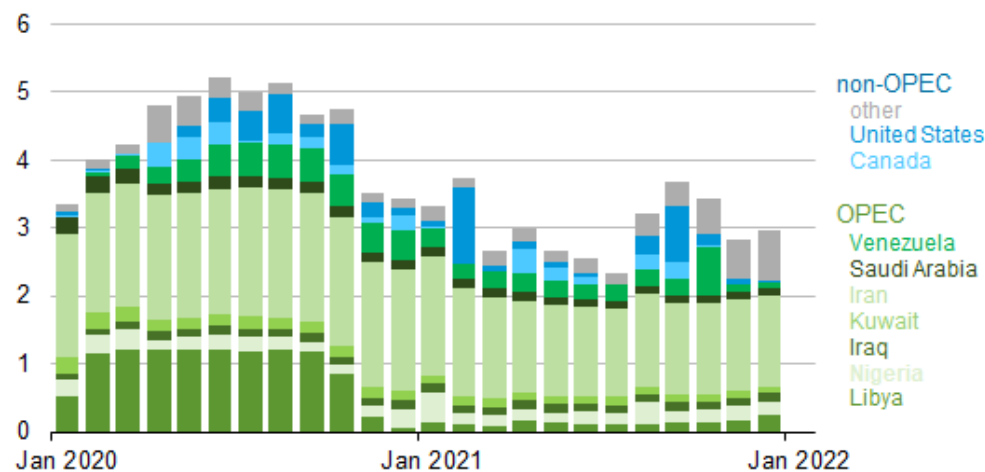
Well, OPEC has again failed to meet its own production targets, this time for the month of January. The cartel lifted production by only an additional 210,000 bpd [barrels per day] instead of the 400,000 bpd increase agreed to thus creating a shortfall of 190,000 bpd. Though that might not seem like a heady amount, the actual shortfall is much larger. Retroactively, the volumes that OPEC was working with in addition to planned increases from prior months show a much larger shortfall. OPEC's actual January cumulative production cuts sum to around 2.8 million barrels per day, greater than pledged cut for January of 2.129 million barrels. This equates to an extra 674,000 bpd in cuts for January than what OPEC has agreed to. In terms of actual production, OPEC produced 27.8 million bpd in December, lifting this to 28.01 million bpd in January. Noteworthy increases came from Saudi Arabia (+100,000 bpd), Nigeria (+50,000 bpd), and the UAE and Kuwait (+40,000 bpd each).

These production gains were partially offset by decreased output by Iraq (-30,000 bpd) and Libya (-40,000 bpd). Years of underinvestment in aging oil fields has meant extraction facilities are ill equipped to magically raise production with the flick of a switch.

**Figure 1: Estimated unplanned liquid fuels production outages among OPEC and non-OPEC producers**



million barrels per day



Source: U.S. Energy Information Administration, *Short-Term Energy Outlook*, January 2022

**[Oil fields and pipelines along with oil refineries need maintenance and lots of it to stay in shape. If you don't keep up with maintenance, your oil production increases may come to market more slowly. If demand is altered in the interim, it can have a striking impact on the price of oil and energy companies.]**

If we begin looking at the beginning of the cuts, there are only two OPEC members that are producing above their January quotas: Algeria and Gabon. Producers least able to get with the times and ramp up production in terms of percentages are Angola, the Democratic Republic of Congo, Equatorial Guinea, and Nigeria. Nigeria for its part is the world's 11<sup>th</sup> largest producer, so these aren't fringe or peripheral countries in the global oil trade. Yet, out of all of the OPEC members, the Saudis have the most in terms of numbers of barrels to add back into the market as part of the future production ramp up. According to Reuters figures, Saudi Arabia still has 878,000 bpd to add back into the market.

For these reasons, as well as others, The MacNicol Investment Team has chosen a careful, versus brazen, approach to energy companies. We may add to our positions in the future if the supply picture becomes clearer, or if more sustainable demand emerges. But like many oil executives, we cannot invest with \$90 or \$100 oil as our "base case", we have to always think about how bad it can get, which is something I did not do in 2014.

Like oil production globally, expect our position in energy companies here at MacNicol to trickle up or down by quarts rather than barrels because the one that won't be "gushing" if oil prices come back, down is profits.

**The MacNicol Investment Team**



## Behavioural Investing

### This year's resolution? No more resolutions...

This probably won't surprise you but I'm not big on New Year's resolutions. It isn't because I view resolutions as a bad thing to consider. I simply view them as a challenging thing to keep. And it is often this time of year that most of you who do have resolutions start to feel the pressure. Those few extra holiday pounds are by this point long gone but taking your resolution to "the next level" truly requires effort and stamina, which is why so many of us abandon our goals. So why is goal abandonment so common? For answers, I turn to University of Central Florida associate psychology professor Bobby Hoffman, Ph.D.

Hoffman is a specialist in goal abandonment, and he studies why despite the most noble of intentions, many of us commit to a plan of improvement or a personal promise, which likely we will ultimately fail. Whether it's eating better, getting more exercise or having a more positive master/pet relationship with your lazy, disobedient or judgmental pet, Hoffman offers many insights that are directly applicable to the world of savings and investment. Before we get into some of Hoffman's specifics, it is important to look at this issue scientifically.



The primary reason that our improvement efforts flounder is because most aspects of human behavior are fleeting and depletable. We are unable to sustain high levels of performance indefinitely and it is a matter of homeostasis, which is to say that humans innately avoid situations of chronic deficit. In practice, homeostasis means that when we are thirsty, we, when we are tired, we rest, and when we are cold, we seek warmth. Biologically, depletion primarily occurs because of decrements of blood glucose levels, which are expended during periods of high activity. In a healthy individual, restoration is achieved, and depletion eliminated through the normal cycle of proper rest, and this is easily understood by most people. But Hoffman points out that psychological deficits are *also* subject to homeostatic restoration because our mind, like our body, experiences **fatigue** when used extensively. Anyone who has completed a grueling exam or devoted mental energy to a crossword puzzle or memorization task can attest to cognitive exhaustion. For me, it's the enormously complex spreadsheets and financial models that power most of what you see as completed fund facts sheets or performance reports. They aren't that complex, they just can be, to me, and only after a long week. So, what does Hoffman offer to people

who have challenges sticking to their goals, and how can they be translated into a long-term investment plan?

### **1. Have a well-designed plan...**

The first step in the self-regulatory process is to have what Hoffman calls a “premediated” plan. It sounds like something from the world of criminal law but what it really means is not approaching a resolution effort with an impulsive or lackadaisical approach, or by jumping into a reform effort headfirst with little, if any, forethought about or consideration of what challenges or obstacles lie ahead. MacNicol & Associates can [greatly] help you with that. By speaking with us or alongside your advisor, we can custom build a portfolio that’s right for you and adjusts with your plan.

### **2. Set realistic targets...**

Sure, we all want to be as rich as Elon Musk, but for most of us, that simply is not going to happen. One of the most frequently encountered roadblocks toward staying the course is being overly aggressive when setting investing goals. We are especially well equipped to guide you and your family on what a reasonable rate of return is for a given level of risk taken.

### **3. Get social support...**

Many investors operate under the false belief that their knowledge or control of strategies are sufficient to reach their objectives. While a certain base level of responsibility is needed, the influence of others is also a contributing factor in optimizing goal attainment. That’s why our firm puts out tons of great content to help you feel like you are part of the investment process here at MacNicol, and frankly, you are.

### **4. Employ technology...**

The pandemic offered the world several lessons. At our firm, the big thing we learned was that by embracing technology we could connect with our clients more often and optimize both their time and ours.

### **5. Failure is part of success...**

Hoffman notes that Steven King’s first novel *Carrie* was rejected 30 times before it was finally published, Stephen Spielberg was kicked out of film school three times, and Walt Disney was once fired as a newspaper reporter because he lacked creativity. Creative and investing don’t always go hand in hand. As a matter of fact, they often end in disaster. But we feel we have innovative, well thought out investment solutions for all of our clients. But despite our best efforts, we don’t bat a thousand. We will however strive to tell you what worked and what didn’t so that you can be more well informed about your investments in an ever-changing world.

Although Bobby Hoffman is a psychology professor, we think he would make a dandy financial advisor. Saving for one’s future is something everyone should resolve to do; it just doesn’t have to feel like another resolution.

### **The MacNicol Investment Team**

## **Firm Wide News**

We are pleased to announce that Ken Reid has joined us full time as a Research Associate. As a Co-op student at Ryerson University, he worked with us for several months during his work terms. Ken has now graduated with a Bachelor of Commerce degree with a specialization in Accounting and Finance. Among his many interests, Ken enjoys hockey and running.

We are excited to have Ken join our team!

Additionally, we are looking to hire a new Associate Portfolio Manager. Hopefully, we will be able to update you with more details in our next commentary.

Now that we are all going into the office more often, it will be a busy place with the new team members.