June 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.

"Good memories are our second chance at happiness."

- Her Majesty Queen Elizabeth, II

The Numbers:

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Index:		**2022 YTD:**
S&P/TSX:		- 2.33%
NASDAQ:		- 22.78%
Dow Jones:		- 9.25%
S&P500:		- 13.3%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	2.1%	1.60%
5-Year Bond:	3.31%	3.22%
10-Year Bond:	3.40%	3.15%
30-Year Bond:	3.33%	3.25%

Economic Data:

- Stocks attempt a rebound in late May
- Oil higher in May to $114 per barrel
- Gold fell 3.3% on firming US yields
- BITCOIN off sharply in May
- US payrolls rose 390k in May above the 328k estimate
- US unemployment rate held in at 3.6%
- Uranium prices spent most of May giving back gains earned in late March
- Bank of Canada raised the overnight rate to 1.5% with a 50-basis point hike

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	19	27
P/B: Price-to-Book	4.0	4.3
P/S: Price-to-Sales	2.6	2.8
Yield: Dividend Yield	1.5%	1.4%

2022 Year to Date Performance, by Sector: June 1st, 2022

S&P/TSX Composite	-2.33%
NASDAQ	-22.78%
Dow Jones Industrials	-9.25%
S&P 500	-13.3%
Russel 2000 (Small Caps)	-12%
MSCI ACWI ex-USA	-10.7%
Crude Oil Spot (WTI)	63.1%
Gold Bullion ($US/Troy Ounce)	3.8%
SOX Semi-conductor Index	-22.7%
VIX Volatility Index	52.1%

Source: Canaccord Genuity Capital Markets & Thomson Reuters

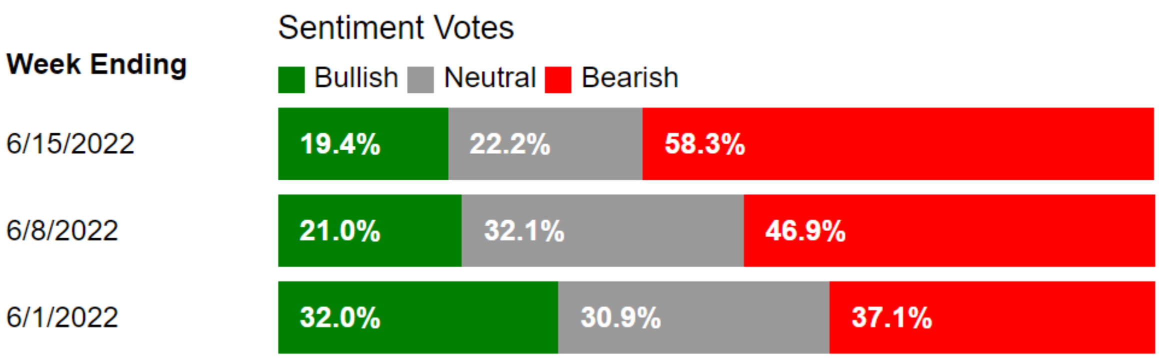
Foreign Exchange – FX

As of June 22, 2:00 pm	$ 5,000	Cdn		
Banks	Rate	**Buy USD**	**Cost**	**% Difference from Spot Rate**
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.2918	$ 3,871	$ (1)	0.0%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.3041	$ 3,834	$ (38)	-1.0%
Raymond James	1.3071	$ 3,825	$ (47)	-1.2%
Royal Bank	1.3201	$ 3,788	$ (84)	-2.2%
Scotia	1.3273	$ 3,767	$ (105)	-2.8%
TD	1.3278	$ 3,766	$ (106)	-2.8%
Canadian Snowbird	1.2727	$ 3,929	$ 57	1.4%
Spot Rate	1.2914	$ 3,872	$ -	0.0%

Compendium of doom…

The chances of a reprieve for beleaguered equity markets were present during most of the second half of May. Russia's war with Ukraine, was no longer news. The prospect for tighter central policy was more than just a prospect. Pandemic skittishness has cooled considerably. And even inflation had become so mainstream that comparing outrageous food, fuel and materials prices became something of a national past time. May therefore did not offer investors any *new* things to worry about and so equities staged what at the time looked like a rebound. With stocks appearing as though they had wanted to go higher in late May, our overall portfolio positioning was broadly the same. Why didn't we add to stocks in May? We held off because most of the root causes for weakness in stocks remained the same across May and into June. Stubbornly high inflation, rising interest rates and fears of a sharp economic slowdown are still with us. Since we have alternatives to investing only in stocks and since the current backdrop for stocks was not unanimously bullish, we figured we would wait it out. It is worth pointing out that Canadian markets have held up much better thus far in 2022, and we expect this outperformance to continue given the Canadian market's exposure to materials and energy which have functioned as inflation hedges during previous market cycles. Valuations in Canadian equity markets have also helped cushion the blow experienced by investors in other markets. More of the stocks we had been selectively buying recently have been from areas like the materials sector and then energy patch.

Another thing we noticed is that the market may not have finished discounting all the bad news coming its way. And by “bad news coming its way” we of course mean revisions to consensus earnings estimates that now must factor in the one-two punch of higher input costs and potentially stagnating demand. You will notice from the sentiment table below, which is published by the American Association of Individual Investors each week, investor attitude towards stocks actually cooled heading into June despite stocks attempting to stage a rebound.



[Investor sentiment declined shortly after May 2022 and more investors were selling into strength than buying dips.]

One final melt up is for the time being our base case scenario. But what would it take for us to become more optimistic about stocks? For one thing, assurance that inflation is under control would make us very happy. Consumers and businesses could resume plans for personal and corporate budgets with greater clarity, and we as an asset manager would be less worried about a policy error at the monetary policy level. We don’t doubt that taming inflation will be easy: simply sourcing inflation’s root cause involves more than accusing central banks of years of lax policy. These days the world’s supply chains are still recovering from dislocations that have their origins in the past US administration and which were compounded by COVID. Items like auto parts are still being produced, however their absence and therefore price elasticity have more to do with cardboard shortages that go into packaging the chips and parts than a lack of the components themselves. Achieving a more balanced inflationary environment could take time and a multifactor approach. But the Fed and the Bank of Canada are taking inflation seriously by raising rates more forcefully to prevent prices from rising even higher. A second thing we would love to see is more compelling evidence that Western economies will avoid a recession. We are not specifically forecasting a recession; however, it has become more difficult in recent weeks to look past the likelihood of a recession happening. The real question is whether the landing will be smooth or turbulent.

Firm landing?

So, can central banks orchestrate a soft landing which lowers inflation while avoiding an outright recession? Admittedly, it has been a very tricky thing to land historically, but the US Fed did manage to do just that as recently as 1994. And, given the coordination on the part of the US Fed and the Bank of Canada, along with Canada's economy tracking the U.S. economy, we have a remarkably similar pattern of rate hikes and economic touchdowns. Some of us were still in university when the most dramatic example of a rate hike cycle happened in Canada but back in the 1990s, rates went up by 400 bps in a year and the economy avoided a total collapse. A similar episode occurred in 1984 and 1985. If history is any guide, we are most of the way through this cyclical bear already. They last about half and decline by about 20%. As of today, the S&P 500 is 5 months into its bearish correction and off roughly 14% from its January peak. More importantly, it usually takes the S&P 500 less than a year to get back to its prior bull market peak. That means we should be back making new all-time highs either in Q4 of this year or early 2023.

At some point, the time for elevated levels of equity exposure will be upon us, but that time is not now. A more cautious approach to stocks and sectors is warranted as are holdings in cash and alternative assets.

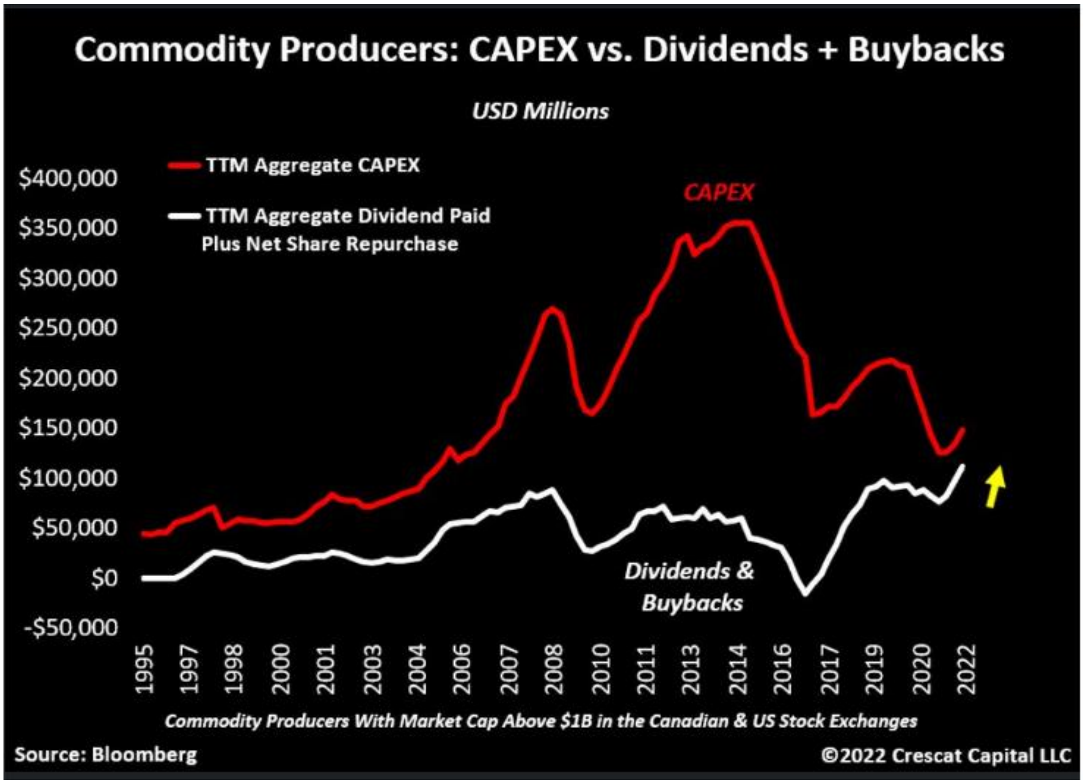
The never-ending energy bull run…

We have all been hearing about it day and night in the main media outlets. Ever since oil futures went negative in April 2020 during the pandemic shock, energy prices have done nothing but keep on climbing, and now we are edging closer and closer to an all-time high. It's crazy the volatility that we have endured the past 2 years. Imagine if I would have told you that WTI and gas prices would be close to or at an all-time high back in 2020 two years from now, you would have laughed, and I probably would have been fired. Yet here we are 2 years later. To understand how we got to this point, one must understand the factors that drive energy prices in general.

[Source: Trading Economics]

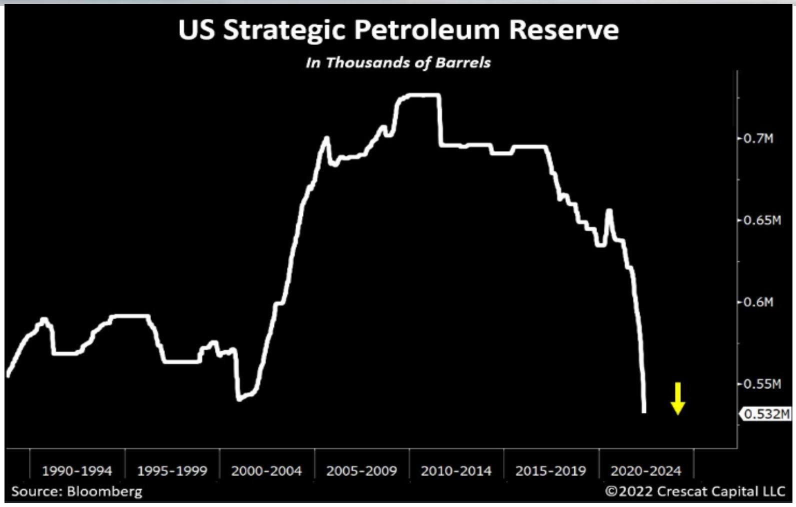
Supply

For years governments have been looking to reduce their reliance on fossil fuels and transition to green energy. One of their strategies to achieve this has been to discourage investment in fossil fuels by encouraging ESG investing and effectively raising the cost of capital for O&G producers. A clear example of this rhetoric is the elimination of the O&G sector from the Flow-Through program by the Canadian government. For those that do not know, the Flow-Through program allows exploration companies to "pass-through" their exploration costs as tax deductions to investors, as such they can raise more capital for exploration activities at a cheaper cost of capital. The result:



Companies are prioritizing returning capital to shareholders via dividends and buybacks over reinvesting the money in the business and increasing production. If governments are actively working towards making fossil fuels obsolete, why would they invest in projects that will not be profitable? As a result, the Biden administration has responded by pledging to release of over 40% of the Strategic Petroleum Reserves (SPR) over the rest of the year. This will take the strategic reserve to levels not seen since 1984. The initial response in markets has been mild without a significant impact on the price of crude oil or gasoline. What makes matters worse is that this creates future demand once it must be bought back to replenish the inventories in the future, potentially at higher prices.

As of today, supply is very low with crude oil stocks hitting a 5-year low as we approach the peak demand summer months. As of April 2022, the EAI is forecasting total 2022 supply to be 99.1 million BPD.



Demand

Demand is high, after 2 years of pandemic lockdowns and relatively subdued demand, people are traveling again, some are coming back to the office and driving more. Not to mention China is opening its economy again after many months of strict lockdowns. Therefore, going forward it is expected that demand will rebound sharply over the summer months. As of April 2022, the EIA is forecasting total oil demand to be 99.4 million BPD for 2022. However, we suspect it could be higher as China opens its economy again.

Geopolitics

As the war in Ukraine continues, western countries continue to work towards reducing their oil imports from Russia, which as we all know is helping Putin finance the war in Ukraine. On May 30th the EU agreed to ban Russian oil imports that arrive via sea by the end of the year, meaning a total of 90% of Russian oil directed to the EU will be blocked. This is significant since if Russia cannot redirect the oil to more Russian-friendly countries such as China and India, a lot of supply will come off the market. Since the announcement, oil prices are up almost 4%. Saudi Arabia agreed along with other OPEC+ producers to accelerate production from September into July and August which are the two peak demand months. The monthly increases should be about 650,000 BPD. However, this has not helped ease the increase in prices. This is because many OPEC+ members are already hitting capacity constraints and the market knows it is very likely that quotas will not be met. All told, it is expected that OPEC+ will only manage to increase output by 355,000 BPD in the next two months. This sum is small compared to the 3 million BPD of oil supply that could be lost from Russa in the second half of the year as the sanctions tighten according to the EAI. All in all, with supply hitting capacity constraints, demand increasing as China and the rest of the world finishes opening their economies, oil and gas stocks hitting a 5 year low, the fight in Russia intensifying and sanctions becoming more severe, a supply gap forming, 99.4 million BPD in Demand vs. 99.1 million BPD Supplied, and green energy policies discouraging investment in the sector, it's very hard to find the bear case for the sector in the near future. As I am writing this article, Goldman Sachs has raised its short-term target for Brent crude from $125 to $140. In the end, anything is possible in markets as we have seen during the past two years. However, the outlook for this sector remains extremely positive with a lot of tailwinds, therefore, I would not bet on my gas bill going lower this summer.

Positive thinking…

Dr. Tchiki Davis, Ph.D., is a wellness content writer, and creator of berkeleywellbeing.com. Davis is an expert in the topic of positive thinking, and positive thinking is something I think we can all use after the market malaise we have witnessed. Positive thinking can be thought of as positive cognitions. This, says Davis distinguishes positive thinking from emotions, behaviors, and longer-term outcomes like wellbeing or depression.

Davis notes that other researchers have explored the different dimensions of positive thinking and have suggested that positive thinking can be understood as a construct with four dimensions: self-encouragement, self-assertive thinking, self-controlled thinking & self-affirmative thinking. Each one of these four critical components of a constructive positive thinking plan have applications when it comes to investing. Self-encouragement is all about believing in yourself and your ability to overcome your own limitations. Maybe picking oil and gas stocks simply isn't your thing. But that does not mean you cannot benefit from the profit potential many of today's oil and gas stocks offer investors. Self-assertive thinking obviously means having a keen sense of yourself and your value and acknowledging that you deserve to get what you want. Self-assertive thinking can help free yourself of the "that's good enough" mentality that sometimes follows years of challenging or sub optimal investing results. Self-control is the ability to manage one's impulses, emotions, and behaviors to achieve long-term goals and although it can be extremely difficult when it comes to financial matters, self-control is what separates humans from beings that have a lower cognitive ability. With this point, we aren't saying that many of the feelings that come with a volatile stock or bond market are feeling you should not have. Instead, what you can draw from the self-control dimension is the ability to draft and stick to a long-term financial plan that you can refer to. It doesn't have to be complex or lengthy. A disciplined plan can be as easy as establishing a regular pattern of savings and checking in with your portfolio manager periodically for updates about the evolution of financial markets and the evolution of you. Self-affirmation is any behavior that confirms the moral and adaptive adequacy of the self. You are more than adequate to be successful with your finances and you have the ability to reach your goals. Sometimes, the best thing you can do in an investment environment like 2022 is think positively. If that proves to be a more formidable challenge for you, then feel free to speak with us. Often times, simply speaking with us about the current status of financial markets can make you feel better about your investments so that you can think positively and reach your long-term goals.