

September 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.

*"I hated every minute of training, but I said, 'Don't quit. Suffer now and live the rest of your life as a champion.'"*

- Muhammed Ali

The Numbers:

<u>Index:</u>	<u>2022 YTD:</u>	
S&P/TSX:		- 8.9%
NASDAQ:		- 24.5%
Dow Jones:		- 13.3%
S&P500:		- 17.0%
<u>Interest Rates:</u>	<u>Canada</u>	<u>USA</u>
90-Day T-Bill:	3.36%	3.55%
5-Year Bond:	3.21%	3.39%
10-Year Bond:	3.10%	3.28%
30-Year Bond:	3.12%	3.44%
<u>Economic Data:</u>		
<ul style="list-style-type: none"> <li>• Stocks mostly lower in August</li> <li>• Crude oil off 9% helps ease some inflationary pressures</li> <li>• Gold rebounds towards the start of August</li> <li>• US unemployment ticks up to 3.7% in August</li> <li>• The Bank of Canada increased the overnight rate to 3¼%, with the Bank Rate at 3½% and the deposit rate at 3¼%</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	21	25
P/B: Price-to-Book	4.0	4.4
P/S: Price-to-Sales	2.5	2.9
Yield: Dividend Yield	1.5%	1.4%

### 2022 Year to Date Performance, by Sector: Aug 30<sup>th</sup>, 2022

S&P/TSX Composite	-8.9%
NASDAQ	-24.5%
Dow Jones Industrials	-13.3%
S&P 500	-17.0%
Russel 2000 (Small Caps)	-12%
MSCI ACWI ex-USA	-18.9%
Crude Oil Spot (WTI)	34.8%
Gold Bullion (\$US/Troy Ounce)	-7.3%
SOX Semi-conductor Index	-12.7%
VIX Volatility Index	-11.0%
Source: Canaccord Genuity Capital Markets & Thomson Reuters	

## **Foreign Exchange - FX**

As of September 13, 9:00 AM	\$5,000	Cdn		
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.3084	\$3,821	\$1	0.0%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.3315	\$3,755	\$(65)	-1.7%
Raymond James	1.3190	\$3,791	\$(30)	-0.8%
Royal Bank	1.3340	\$3,748	\$(72)	-1.9%
Scotia	1.3345	\$3,747	\$(74)	-2.0%
TD	1.3431	\$3,723	\$(98)	-2.6%
Canadian Snowbird	1.3271	\$3,768	\$(53)	-1.4%
Spot Rate	1.3087	\$3,821	\$-	0.0%

## **Blink and you'll miss it: the Summer (rally)**

With Canadian airports in shambles and COVID a sort of ubiquitous parasitic presence, I decided that it would be a good idea to take the family on an Alaskan cruise with the Walt Disney company (NYSE-DIS) this Summer. I have never been on a cruise before, and I really looked forward to going. Naturally, two concerns immediately came to mind: sea sickness and mind-bending delays at the airport. With the sheer size of the Disney “Wonder”, the ship we would be sailing on, being equivalent to a *medium* sized Toronto office and given both the Strait of Georgia and the Johnston Strait’s reputation as smoother routes, I didn’t think sea sickness would be an issue. And it wasn’t. As far as travel delays went, I decided to travel with carry-on luggage only. The 11 pound per bag weight limit made packing a challenge, but I was strategic and selective, and in the end the exercise was well worth the freedom of not having to lug around larger pieces of luggage around YYZ and downtown Vancouver. The food was excellent and the entertainment in typical Disney fashion was excellent but the stock market as I found out was anything but...

## **Ladies and gentlemen this is the captain speaking...**

The Summer rally in stocks that began in late June encountered rough seas during the second half of August, which happened to coincide with the time I was away. The S&P 500 fell by 4.24%, the NASDAQ fell by 4.64% and the Dow Jones Industrial Average fell by 4.06% and yes, I will try to inform you all prior to going on vacation again soon. If only I was that important! But the economy *is* that important and from June 16<sup>th</sup> to August 17<sup>th</sup> stocks rebounded on hopes that a cooling economy might elicit less Hawkish guidance from both the Bank of Canada and The Fed. The hope was that inflation would blunt the forceful approach towards inflation that central banks told us they would have to take, raising interest rates and reducing bond buying programs known as quantitative easing. Those hopes were abandoned when US Fed Chair Jerome Powell said that he did **not** expect to see a quick decline in inflation at a speech in Jackson Hole, Wyoming. And that inflation fighting mission continued more recently with remarks Powell made at the CATO Institute. Unanimously hawkish public remarks by central bankers leave little doubt that rates are going higher. But just like in sailing your ultimate direction and velocity are a function of several competing crosscurrents.

Predicting exactly what central banks will do next is of course an exercise in futility. And we certainly won't attempt to do that here. However, one possible clue as to what central banks *may* do comes from the labour market. The US labour market is strong, period. But the unemployment rate did increase from 3.5% to 3.7% in August and if we strip out COVID we haven't seen a 20-basis point increase in this metric in a little while.

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2012	8.3	8.3	8.2	8.2	8.2	8.2	8.2	8.1	7.8	7.8	7.7	7.9
2013	8.0	7.7	7.5	7.6	7.5	7.5	7.3	7.2	7.2	7.2	6.9	6.7
2014	6.6	6.7	6.7	6.2	6.3	6.1	6.2	6.1	5.9	5.7	5.8	5.6
2015	5.7	5.5	5.4	5.4	5.6	5.3	5.2	5.1	5.0	5.0	5.1	5.0
2016	4.8	4.9	5.0	5.1	4.8	4.9	4.8	4.9	5.0	4.9	4.7	4.7
2017	4.7	4.6	4.4	4.4	4.4	4.3	4.3	4.4	4.3	4.2	4.2	4.1
2018	4.0	4.1	4.0	4.0	3.8	4.0	3.8	3.8	3.7	3.8	3.8	3.9
2019	4.0	3.8	3.8	3.6	3.6	3.6	3.7	3.7	3.5	3.6	3.6	3.6
2020	3.5	3.5	4.4	14.7	13.2	11.0	10.2	8.4	7.9	6.9	6.7	6.7
2021	6.4	6.2	6.0	6.0	5.8	5.9	5.4	5.2	4.7	4.6	4.2	3.9
2022	4.0	3.8	3.6	3.6	3.6	3.6	3.5	3.7				

[The US labour market is still quite strong, but layoffs are coming. Source: Bureau of Labour Statistics]

New jobs were indeed added to the economy, but those additions were offset by firings in areas like retail, media, and technology. In fact, layoffs are becoming an increasingly prevalent part of like here in the second half of 2022. Bed Bath & Beyond (**BBBY-NASDAQ**) announced a range of “strategic” changes to improve business on Aug. 31<sup>st</sup>. The changes include layoffs, store closures and a potential sale of up to 12 million new shares in the company. PVH Corporation (**PVH-NASDAQ**) parent of Tommy Hilfiger, Calvin Klein and Heritage Brands said it plans to reduce people costs in its offices around the world by 10% over the next year and invest in digital supply chain and consumer engagement initiatives. PVH Corp., has 19,000 full-time employees. Snap-chat maker Snap (**SNAP-NYSE**) announced on August 31<sup>st</sup> that it is laying off 20% of its staff to reaccelerate revenue growth. Snap employs 6,400 people. And just today, an internal directive from internet search juggernaut Alphabet/Google (**GOOG-NASDAQ**) told managers to cool it when it came to spending on meals, entertainment and especially happy hour. Sundar Pichai also hinted to layoffs by stating that he would like to make Google 20% more efficient.



[Coinbase, Lyft, NetFlix, Peloton have all let staff go in 2022. But it is not only retail or tech companies that are handing out pink slips. Ford announced in late-August plans to lay off 2,000 salaried workers and 1,000 contract workers across the US, Canada and India — with a large percentage of these layoffs occurring in Michigan.]

Since 1991, the US unemployment rate has averaged 5.91% or 5.84% if you strip out COVID from data provided from the Bureau of Labour Statistics. It is unlikely that the US unemployment hits its 30-year average of nearly 6% prior to my next trip, but if anything, the aforementioned signs of the labour market cooling are an antecedent for bankers to at least start thinking about thinking about slowing the pace of its interest rate hikes, in order to avoid a more severe recession.



[We quote the Bureau of Labour Statistics often, and so we should. As the definitive lagging economic indicator, unemployment statistics tell us an awful lot about where to invest capital in our 360 Degree US Realty Income Partnership.]



But that won't be soon. Barring a major decline in overall economic activity, the MacNicol Investment Team is not factoring in a reduction in the pace of interest rates increases, or a cut, at any point until at least the final quarter of 2023 and we think this means that rallies in stocks are likely to be brief and centered around quality. Timing the markets is a mug's game and we try to avoid doing that here. However, the quality of our public and private market investments, we think, will be the defining characteristics of *your* rally continuing long into the future, regardless of what markets do.

As we set to return back to Toronto, two (2) individual delays with the plane we were to take resulted in an official back home arrival time of 5:23am. Yes, I had less baggage to carry, I just had to carry it for 4 hours longer than planned!

If there is a silver lining in travel delays and sea sickness it is that one ends up appreciating one's time with his family and dry, solid ground that much more. In a similar way, the silver lining in the dark cloud that is a monetary establishment hell bent on taming inflation is that a tidal wave of rate hikes now offers bankers the leverage to reduce rates if conditions warrant. We don't expect that to happen, but you never know right.

The Summer rally in stocks was brief as was my time in Alaska. I would gladly take a cruise again and the MacNicol Investment Team is happy to continue to steward you and your family to a safe place no matter what the prevailing market conditions may be.

### **What is the solution to high oil prices?**



I was never really a fan of television, but gameshows were a notable exception. There was that show with the big wheel contestants would spin to pick letters which solved a word puzzle, the one where contestants in funny outfits would try to make a "deal", the one where the host would remind us to get our pets spayed or neutered when he wasn't busy fighting "Happy Gilmore" (Adam Sandler) on a golf course, and of course, the trivia show where the host would request that contestants provide the presumed question to a stated *answer*.

They were all good and all memorable, but yes *Jeopardy* was my favorite. But enjoyment aside, I would never be a serious contender on the show. Instead, I think I would make a decent answer writer.

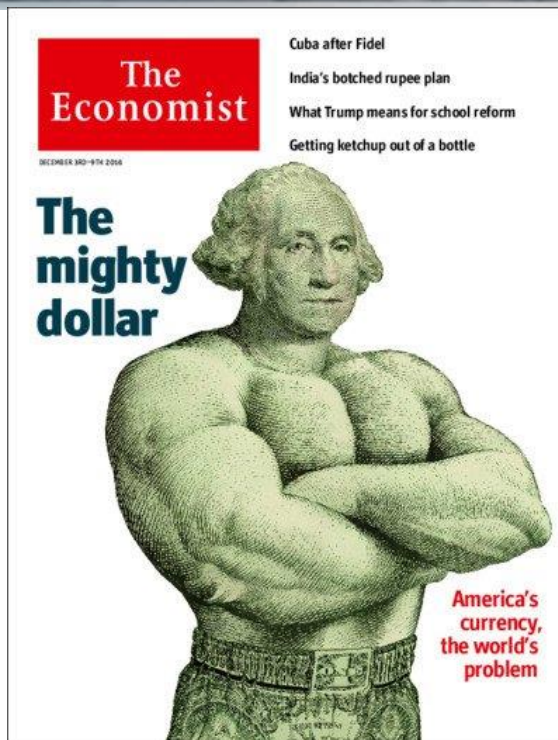


[Alex Trebek was an amazing host, so was Monty Hall. Who will forget Trebek’s sharp wit and Hall’s bold suit/tie combinations?]

Yes, gameshows are fun especially when contestants land windfall gains. The same cannot always be said about the world of commodities and commodity investments. Trading in oil and gas futures is serious business. Serious and big. In the world of commodities, no other individual futures contract trades more than crude oil. Here in North America, the benchmark price for crude oil is defined by the price of West Texas Intermediate (WTI) grade oil available for delivery in Cushing, Oklahoma. WTI prices posted their low for 2021 in January at \$47.18 a barrel. But crude prices moved higher as 2021 went on, pausing only in October that year when U.S. crude oil stockpiles increased more than expected. From November 2021 until just this past June, crude prices soared on tight global supplies and the disruption created by the war in Europe. Reduced oil output from OPEC led to even tighter global supplies after the cartel announced in March that they would in fact not restart 500,000 barrels per day of additional daily output in April. Oil also rose on signs the global economy was recovering from the pandemic, which led to a rebound in energy demand. A related factor was US stocks. Stocks were mostly higher during the fourth quarter of 2021 and the S&P500 ran comfortably into the 4,700-point range by December before taking a pause. Higher stock prices bolstered confidence in energy demand and the overall economic picture.



Crude prices then fell back briefly into September on concern that worsening financial troubles in China's property market could threaten its economy and energy demand. The name Evergrande Group, a Chinese real estate developer was talked about constantly back then and that story continues today. The spread of the Delta Variant of Covid in late 2021 led to lockdowns and travel restrictions that reduced energy demand. Yet, crude prices somehow managed to rally into October and posted a then 7-year high of \$85.41 per barrel as American oil supplies dwindled. Hurricane “Ida”, a named, 150 mile per hour wind, shut down most U.S. gulf coast offshore production and restrained work at several refineries. Crude inventories in the states next tumbled to a 3-year low in September at 414 million barrels. Then came the Omicron Variant of COVID which caused crude prices to drop by more than \$10 a barrel. The US dollar also played a role as it somehow does in just about everything. Specifically, the dollar index rallied to a 1-year high as a surge of inflation raised the prospects of The Fed raising interest rates at a cadence not seen in decades.



[This isn't a recent cover of *The Economist* it's from December 2016, the US dollar was the talk-of-the-town then too.]

Crude prices did rebound and finished 2021 sharply higher (up 50% at \$75.21 a barrel) as the overall appetite for personal and business travel increased. That run continued into the current year 2022. Crude oil twice achieved a price level of \$120 per barrel, which led to higher energy prices most notably for drivers. And then it all sort of just stopped. In June of 2022, oil prices began to fall. Weakness emanating from China has played a significant role in lowering oil prices. In North America, fears of demand destruction under rising rates and broader inflation were a negative catalyst and steepened oils plunge through August and into the September. OPEC's joint technical committee mentions it (now) sees an oil surplus this year of 400,000 bpd, up 100,000 bpd from its forecast just a month earlier. So, you see, the energy picture has changed materially over just the past 24 months and we suspect much has yet to be determined in the high stake's world of energy trading. But beyond all the technical or fundamental reasons why oil prices do what they do, we feel the clearest reason is the title of this missive. Yet, when we sit down for our Thursday Research Meetings there are a number of things that come to mind. Numerous headwinds continue to exist for oil including logistical issues in getting energy to where it needs to be more effectively. And from a supply perspective, it appears that the producers in North America remain disciplined for now. From a capital markets perspective, there is too much pressure from shareholders to return capital back to them in the form of dividends and share buybacks as opposed to using those funds to finance production growth. So, in some cases, we believe that we are in that situation where you have won **both** showcases in the "showcase showdown": specifically, that inefficient or low-quality operators go away while participating in oil's recent fortunes. But just like a game show, investing fortunes can change quickly, and so if you had a high cost or low-quality producer that benefitted from a high beta rally run up recently it wouldn't be a bad idea to seek a lower cost bigger producer, that can generate attractive free cash flow at these levels. We can help with that, and you won't even have to buy a vowel.

There are opportunities in energy we certainly aren't saying there aren't. But what we are saying is that oil can be extremely volatile and the stocks that search for it can to. So, let's make a deal: I want you to e-mail me your own answer, or I guess "question" to the answer I had posted in the Jeopardy graphic at the start of this article. If you guess right, I'll be sure to mention you in the firm-wide news section of our very next commentary. But you better move fast, your time is almost up.

### **Behavioral Investing: Representative Heuristics and the silly choices they can cause**

Are you an oil and gas executive in Calgary or Dallas who recently purchased a new Ferrari or an expensive boat? Sure, shiny, new, and expensive things are fun to acquire, and oil and gas companies are literally printing money at the moment. But will it continue? We attempted to answer this question in *Let's Make a Deal* but the point there was more basic and more mechanical. Here we attempt to use oil's campaign thus far in 2022 as a cautionary tail of what can happen when investors take to basking in the glow of past success too far. Investors should be skeptical of rallies in crude, at least for the time being. A range of global economic challenges, supply uncertainties, and most importantly demand destruction fears may illicit selling into strength rather than new highs.

## BEHAVIORAL FINANCE



### **Representative Heuristic**

Representativeness heuristic is a psychological bias in the world of behavioral investing where investors are prone to believe that a history of remarkable performance is representative of performance that continue. After lengthy travails in the energy space, now might indeed be the time to celebrate with a little "treat" for one's patience and persistence. But it's important not to let success get to your head. A healthy attitude towards portfolio rebalancing is always appropriate, but crude realities are in store for those who took gushing profits too far and overextended themselves. As they say, the solution to high oil prices is high oil prices.

But what is the solution to a psychological bias that makes you feel that the future will be like the past? One possible solution is to come speak with us. The MacNicol Investment team doesn't hold itself out as investing geniuses to the world. What we are instead is a talented and dedicated group of professionals who apply a time-tested and disciplined investment process that is unbiased, objective and most importantly of all independent.



## The MacNicol Investment Team

### Firm Wide News

David and Diane MacNicol ran into a Canadian legend this past month.

