

September 2022

The Quarterly

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.

“Disciplining yourself to do what you know is right and important, although difficult, is the high road to pride, self-esteem, and personal satisfaction.”

- Margaret Thatcher

The Numbers:

<u>Index:</u>	<u>2022 YTD:</u>	
S&P/TSX:		- 13.1%
NASDAQ:		- 32.4%
Dow Jones:		- 21.0%
S&P500:		- 24.8%
<u>Interest Rates:</u>	<u>Canada</u>	<u>USA</u>
90-Day T-Bill:	3.64%	3.40%
5-Year Bond:	3.21%	3.84%
10-Year Bond:	3.08%	3.62%
30-Year Bond:	3.10%	3.68%
<u>Economic Data:</u>		
<ul style="list-style-type: none"> • Ghastly British fiscal policy mistake wreaks havoc on gilts, pound • Commodities ex-Silver mainly lower in September • “Emergency” US Fed meeting announced late September (October 3rd, 2022) • All major stock markets lower in September • CADUSD off 4.7% in September on higher rate expectations in the United States 		

<u>Valuation Measures: S&P 500</u>		
<u>Valuation</u>	<u>Latest</u>	<u>1-year</u>
P/E: Price-to-Earnings	18.6	24.4
P/B: Price-to-Book	3.6	4.4
P/S: Price-to-Sales	2.3	2.9
Yield: Dividend Yield	1.7%	1.3%
<u>2022 Year to Date Performance, by Sector:</u> Sept 30 th , 2022		
S&P/TSX Composite		-13.1%
NASDAQ		-32.4%
Dow Jones Industrials		-21.0%
S&P 500		-24.8%
Russel 2000 (Small Caps)		-15%
MSCI ACWI ex-USA		-26.7%
Crude Oil Spot (WTI)		20.1%
Gold Bullion (\$US/Troy Ounce)		-10.2%
SOX Semi-conductor Index		-41.6%
VIX Volatility Index		4.53%
Source: Canaccord Genuity Capital Markets & Thomson		

Foreign Exchange - FX

As of October 17, 10:00 AM	\$5,000	Cdn		
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.3737	\$3,640	\$(2)	-0.1%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.4175	\$3,527	\$(115)	-3.2%
Raymond James	1.3915	\$3,593	\$(49)	-1.4%
Royal Bank	1.4026	\$3,565	\$(77)	-2.2%
Scotia	1.4256	\$3,507	\$(135)	-3.8%
TD	1.4087	\$3,549	\$(93)	-2.6%
Canadian Snowbird	1.3764	\$3,633	\$(9)	-0.3%
Spot Rate	1.3729	\$3,642	\$-	0.0%

It's a matter of *Truss*

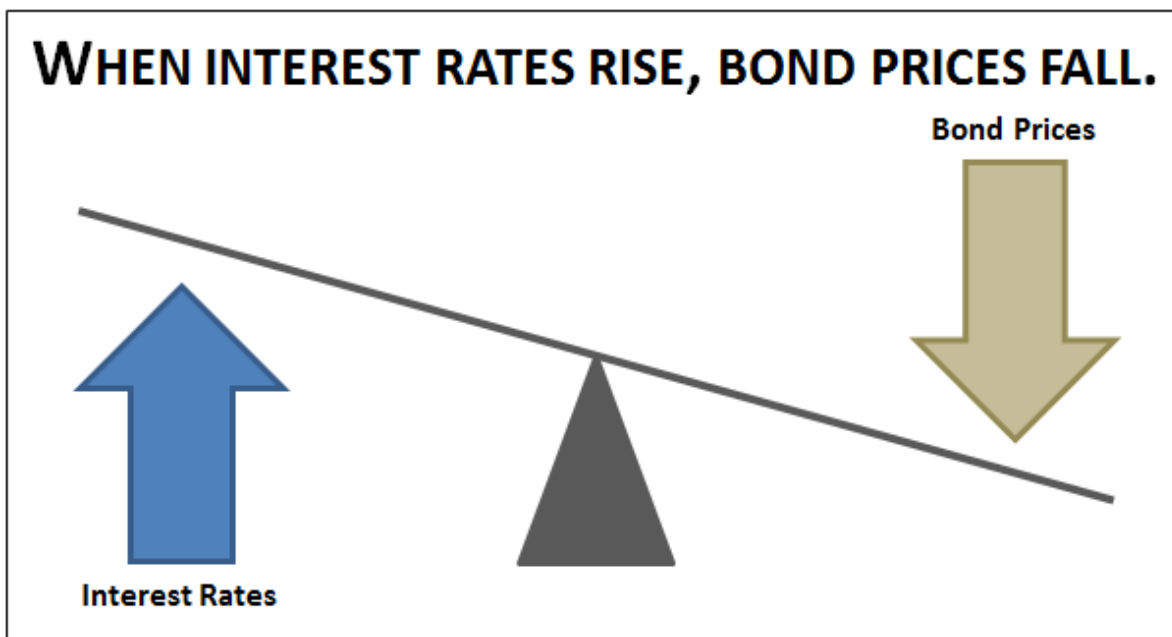


Former Bank of England (and Bank of Canada) Governor Mark Carney accused Liz Truss' government of "undercutting" the nation's economic institutions recently. In a radio interview, Mr. Carney went on to suggest that Truss' fiscal free-for-all, a £45 billion tax cut mostly to people who were already successful and assembled by Chancellor of the Exchequer Kwasi Kwarteng, was to blame for the nosedive in sterling and gilts. The basic mechanics of what happened was simple. Truss promised enormous tax cuts to get elected, Kwarteng figured out it would be done, and bond investors decided that they had it with British Treasury securities or "Gilts" as they are known with demand essentially disappearing overnight. The ensuing malaise saw gilt prices crash and yields soar.

Running Britain is expensive and since 1970 the country has only brought in more money than it has spent six (6) times. That's an 11% success rate that, by definition, demands a stable bond market. Tax cuts certainly *can* be used to juice the economy occasionally, but the simple mathematics around Truss' numbers didn't work...not even slightly. Rising yields on gilts signaled to the world that foreign investors like large pension funds, foundations, and groups like us were not interested in picking up the tab for such obvious nepotistic profligacy at a time when the average Brit is feeling the pinch of higher prices and a shifting economy. Even King Charles III is scaling back the pageantry of his own upcoming coronation to be more up with the times and in tune with the people of his realms. Explaining the mechanics behind Truss and Kwarteng's fiscal folly is easy. But what happened next isn't. Read on and you will soon appreciate why soggy foreign relations with your lenders can lead to catastrophic events on the domestic front.

Liability-driven investing

Liability-driven investment "LDI" is an investment policy that focuses on matching current and future liabilities of a pension plans, insurance companies and other large pools of money. LDI can effectively manage portfolio risk and help minimize the impact of what is essentially a gigantic investment jigsaw puzzle on the broader sponsoring organization's financial health since it shifts the focus away from beating benchmarks to improving and stabilizing the funded status of the plan. The word **stabilizing** is key here because the size of the LDI market has exploded over the past decade. The amount of liabilities held by British national pension funds, which have been hedged with LDI strategies, has tripled in size to £1.5 trillion in the 10 years through 2020 according to Bloomberg. So, any time yield on gilts fluctuates, even slightly, the impact can quickly ricochet across the financial system. Shortly after Truss got down to business, demand for gilts plunged and yields skyrocketed as it became increasingly likely that her massive fiscal faux pas was moving forward as planned. The jump in yields triggered massive pension system margin calls and a very disorderly British government bond market that was heretofore known for its Palace-like stability.



[I know several Ph.D., Economists. Yet, time and time again, I continue to find this simple illustration of how bond prices work most useful.]

The problem was so bad that over the weekend, one-by-one, friends of mine began texting that there was “a problem” in the UK, and that a large financial institution was teetering on the precipice of failure. We don’t hold much, if any British assets, either in individual client accounts or the Alternative Asset Trust so I figured the culprit was a hedge fund run by some 25-year-old “scion” (pretty boy) on the verge of blowing up. When I heard that the institution in question was in fact a pension fund, I shouted: “expletive + me”.

By the time I clued into what was going on, The Bank of England had stepped into Britain's bond market to stabilize the gilt market rout. The BoE pledged to buy £65 billion pounds of longer maturity gilts citing potential risks to the stability of the entire British financial system. The BoE also completely stopped the sale (unwind) process of its £838 billion bond portfolio, which was slated to begin around now. These fast, forceful, and gutsy moves by the BoE tell us three things: a) were conditions in the British bond market to worsen, there would be a material risk to British financial stability b) those risks would lead to an unwarranted tightening of financing conditions and a reduction of the flow of credit to the real economy and c) despite back pedaling, Liz Truss quite simply cannot be trusted to spearhead fiscal policy even if her Finance Minister promises no more “distractions”. Truss was the distraction and she caused demand for gilts to evaporate, which in turn spurred heavy selling from U.K. pension funds forced to raise cash (because the very bonds they pledged as collateral for margin loans linked to other investments tanked) a situation we frame as the fallacy of liquidity. Ultimately, the BoE had to bail them out to avoid a wider financial crisis. Being a relatively simple person myself, I can distill the predicament in Britain to three broad issues: financial assets that were worth more than the underlying economic value, excessive use of leverage and a financial system that is engineered to simply transfer risks without first knowing what those risks even are. And therefore, we feel that the global financial system, not just the financial system of Britain, is in the early phases of a painful deleveraging process. The entire world is being choked off its once, seemingly endless supply of cheap money.



[Just look straight ahead and avoid eye contact.]

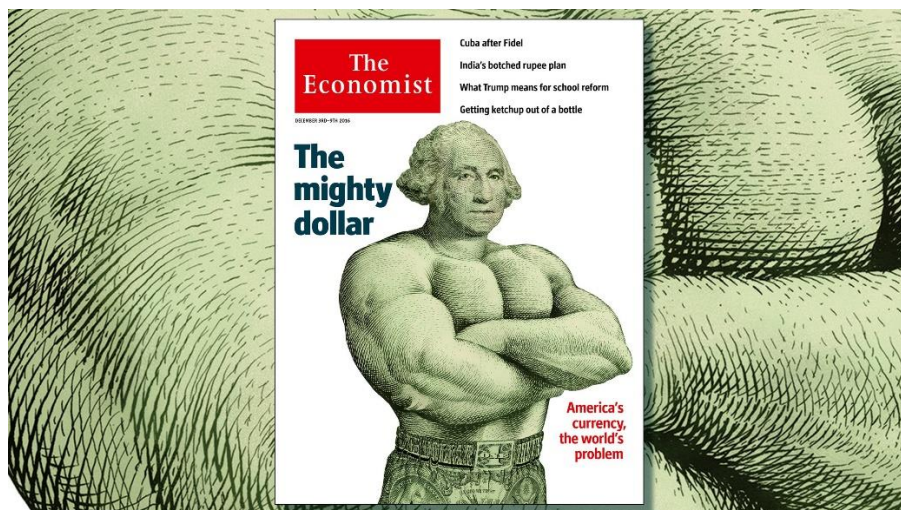
While this article may seem like a hit piece, we are apolitical, and we do not incorporate politics into making investment decisions. We may adjust investment policy as a result of fiscal policy decisions but not in spite of the party making them. With that said, we have steered clear of the UK for an extended period of time. But could that change soon? Who knows. We love the UK and British people, and the pound is (still) the best currency in the world when it comes to having a night-on-the-town. We just feel it might be a good while before we take the plunge. The simple fact of the matter is we don't know who to Truss.

The MacNicol Investment Team

Pricey, but worth it “yall”...



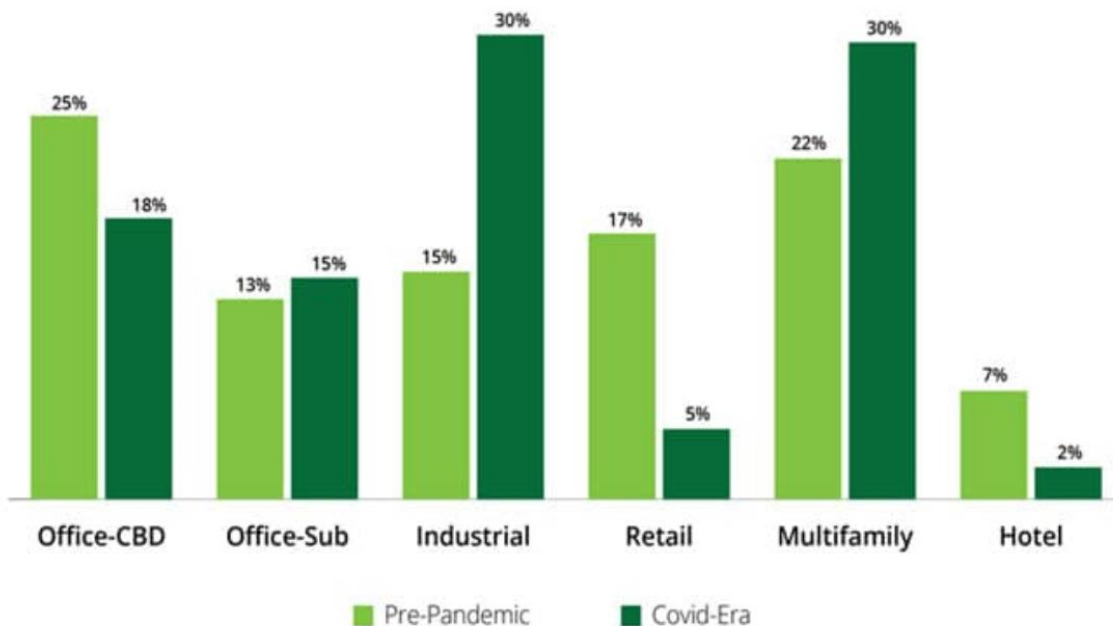
By now most of you know about our decades long love affair with US private real estate. The asset class has been one of the largest creators of wealth ever and it offers investors exposure to that investing sweet spot of attractive long-term returns and acceptable levels of risk. Many large institutional investors, wealthy families, and foreign investors clamor for a chance to own American real estate in their portfolios. But are investors in that latter group, people in places like London, Dubai, or Hong Kong, no longer as vehement about owning buildings in America thanks to the rapid price appreciation of the US dollar?



The answer is **NO**.

A strong US dollar doesn't mean American real estate is weak for foreign investors, but it is affecting the timing of their decisions. Greenbacks have been soaring against other currencies, driven by the Federal Reserve's decision to increase interest rates. Foreign investors have shifted money to U.S. assets that now have higher yields. However, the moves have made properties more expensive for foreigners to acquire. High inflation, concerns about the economic consequences of the war in Ukraine, and questionable fiscal policies abroad (as in the UK) have weakened foreign currencies, but they haven't invalidated the thesis around why US real estate is still a superior asset class to consider. More groups we talk to say that they are **putting off** buying American real estate until the exchange rates swing back in their favor. Others are merely reducing a previously determined, but adjusted, allocation to the space. From a geopolitical perspective, investors are figuring they'd rather not hang out in politically unstable areas like Europe, the Middle East or Asia. Investors continue to size up opportunities for US real estate investment because the space is viewed as a "Safe Haven". Increasing optimism around income growth, coupled with the asset class' stable yields, has seemingly outweighed narrower, currency related concerns bringing the US real estate sector back to the forefront of foreign investing agendas.

Foreign Investor Volume Concentration by Property Type



[Two-thirds of the MacNicol 360 Degree US Realty Income Fund is allocated to either multifamily or industrial properties (Source: CBRE).]

According to CBRE, rents in the industrial space has topped a record high of \$9.10 per square foot. Additionally, the net absorption hit a 30-year annual record of 432.5 million square feet. All this signals robust demand aimed at combatting supply chain disruptions and rising costs of transportation and construction. All good stuff that makes domestic investors such as us like US real estate for the long-term. At the end of the day, despite greenback strength, people are still going to get up in the morning, brush their teeth, go to work, play on their iPhones and eat Big Macs.



If you're a foreigner with lots of money, a very rich person in Greece for instance. The special treatment you get from private American real estate is superb. The consistent underwriting, standardized reporting, ease of doing business, and overall robustness of US commercial real estate are features that makes owning individual buildings in a Greek city, village or town less enticing. Also, Liquidity premiums increase in an uncertain world. And hey, foreign withholdings taxes might not make you an American, but they do make you an American taxpayer.

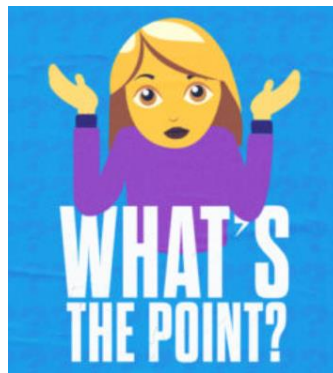


American real estate isn't inexpensive, but then few things that are really good ever are. Foreigners now must pay up for the opportunity to own something private, something real and something **good**. But that price is well worth paying and opens portfolios to greater clarity and a broader perspective. Access to robust fundamentals and demand that's not available in other places means foreign investors will *continue* to flock to US real estate, and they'll be meeting many of us – and you – for the first time. To our valued clients, congratulations, the ball is in our court now.

Behavioral Investing

The utility of futility

Philip Chard is a Psychotherapist, Author, and Trainer. In *Feelings of futility can be hard to shake when they set in*, Chard takes a pragmatic and sensible look at what can happen to one's psyche and soul when life is viewed as little more than a directionless journey through existence. Chard's lessons are important and relevant, and they would not look out of place in an investment newsletter, which is why we share them with you here. Futility, Chard points out, is not an official psychiatric condition that is diagnosed, instead futility is something that can lead to other conditions like depression, fear, and anger by compressing or even debilitating the human spirit. Futility remains an existential condition more than a psychological or emotional one and it is best described by a common question we sometimes ask ourselves:



As one might expect, feeling futile is anathema to motivation, engagement with others and the pursuit of one's dreams - basically, to life's satisfaction. And this is especially true of getting motivated to start saving, engaging with people who can make it happen for you, and sticking to that plan so that you can pursue things that really matter to you. From early on, my parents cooked up a variety of answers to the "What is this all about" questions my sister and I would ask. And frankly, most of the answers were about getting a strong education, finding a good job, and raising a family in order to make good use of one's talents and so on. Most of us embrace at least one of these kinds of paths and then set about trying to make it happen, the premise being that doing so will lead to a happier and more fulfilling existence. But Chard notes that even if we are successful in such strivings, the payoff may seem empty or not worth the sacrifices it required. And, if we fail in our life goals, there is the danger we'll feel hoodwinked by the pretense of chasing rainbows that offer know "gold" at either end.



[Resistance is futile. But futility needn't be.]

Investing is hard in many ways because of course the stock market doesn't always go up. You can work hard and save and realize very mediocre or negative returns in the market, and feel deceived, tricked, or just flat out lied to. And Chard counsels that finding meaning and purpose when your spirits are down often involves talking to someone. At MacNicol & Associates Asset Management, we have been speaking to investors for over 21 years. Our judgement free, no obligation consultations are the perfect way to help you seize futility rather than be dominated by it. We hope the exercise will help you and your savings feel not only more productive and profitable, but better able to function in all aspects of your life.

Firm Wide News

Some of you may have already met Cesar during our Annual Client Reviews. He is the newest member of our team. After a long engagement due to Covid, Cesar and Jessica got married back in March and in September they were able to go to Croatia and France for their honeymoon and had a wonderful time!

