

November 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.

“The Guerrilla must move among the people as a fish swim in the sea.”

Mao Zedong

The Numbers:

| <u>Index:</u> | <u>2022 YTD:</u> | |
|--|------------------|------------|
| S&P/TSX: | | - 8.47% |
| NASDAQ: | | - 29.8% |
| Dow Jones: | | - 9.92% |
| S&P500: | | - 18.7% |
| <u>Interest Rates:</u> | <u>Canada</u> | <u>USA</u> |
| 90-Day T-Bill: | 3.95% | 4.15% |
| 5-Year Bond: | 3.45% | 4.26% |
| 10-Year Bond: | 3.28% | 4.04% |
| 30-Year Bond: | 3.29% | 4.10% |
| <u>Economic Data:</u> | | |
| <ul style="list-style-type: none"> • Stocks mostly higher in October • Stocks in Shanghai lower in October • Crude oil adds 10% during the month • Gold down less than 2% • Bank of Canada and US Fed signal that they are approaching the end of their rate hike campaign • Canadian energy sector gushing profits • Elon Musk states that Tesla is ready to begin production of a “cyber truck” in 2023 | | |

Valuation Measures: S&P 500 Index

| <u>Valuation Measure</u> | <u>Latest</u> | <u>1-year ago</u> |
|--------------------------|---------------|-------------------|
| P/E: Price-to-Earnings | 20 | 24 |
| P/B: Price-to-Book | 3.8 | 4.4 |
| P/S: Price-to-Sales | 2.3 | 2.8 |
| Yield: Dividend Yield | 1.7% | 1.4% |

2022 Year to Date Performance, by Sector: Oct 31st, 2022

| | |
|---|--------|
| S&P/TSX Composite | -8.47% |
| NASDAQ | -29.8% |
| Dow Jones Industrials | -9.92% |
| S&P 500 | -18.7% |
| Russel 2000 (Small Caps) | -14% |
| MSCI ACWI ex-USA | -24.2% |
| Crude Oil Spot (WTI) | 32.3% |
| Gold Bullion (\$US/Troy Ounce) | -11.9% |
| SOX Semi-conductor Index | -14.7% |
| VIX Volatility Index | -13.0% |
| Source: Canaccord Genuity Capital Markets & Thomson Reuters | |

Foreign Exchange - FX

| As of November 4, 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 | \$(61) | -1.7% |
| Laurentian Bank | No Public Rate Posted Online | | | |
| National Bank | 1.3975 | \$3,578 | \$(123) | -3.4% |
| Raymond James | 1.3854 | \$3,609 | \$(91) | -2.5% |
| Royal Bank | 1.3807 | \$3,621 | \$(79) | -2.2% |
| Scotia | 1.3897 | \$3,598 | \$(103) | -2.8% |
| TD | 1.3888 | \$3,600 | \$(100) | -2.8% |
| Canadian Snowbird | 1.3707 | \$3,648 | \$(53) | -1.4% |
| Spot Rate | 1.3512 | \$3,700 | \$- | 0.0% |

Bottom...

One area I like to turn to for guidance on where financial markets could potentially be headed next is Canadian retail mutual fund sales data. At their extremes, retail mutual fund sales data are bits of information worth scrutinizing because they can signal opportunity for those who inspect them closely. Retail mutual fund sales data can be thought about in the same way as the unemployment rate. The unemployment rate is a lagging economic indicator. Lagging because employers don't fire people *in anticipation* of a recession, they fire people *as a result of* a recession. The unemployment rate then provides you with almost no insight into the likelihood of a **pending** recession yet confirms with a very high degree of confidence the existence of a recent recession that you might have thought you noticed earlier. So, is there anything I have noticed in Canadian mutual fund sales statistics that leads me to confirm with a very high degree of confidence that financial markets have potentially bottomed out? As a matter of fact, there is:

| Asset Class | Sep. 2022 | Aug. 2022 |
|--------------------------|-----------|-----------|
| Long-term Funds | | |
| Balanced | (4,992) | (2,429) |
| Equity | (2,884) | (333) |
| Bond | (1,915) | (382) |
| Specialty | 1 | 90 |
| Total Long-term Funds | (9,790) | (3,053) |
| Total Money Market Funds | 825 | (52) |
| Total | (8,965) | (3,105) |

[I don't typically begin these commentaries with data tables. But I think this one, from the Investment Funds Institute of Canada, is quite important. Quite important because the figure \$8,965 displayed in September's "Total" is shown in brackets, denoting redemptions and not new sales, and because it needs to be multiplied (by one million times, to give you a true picture of what actually went down in the Canadian mutual fund industry that month.)

The latest data from the Investment Funds Institute of Canada (IFIC) showed **net redemptions** of nearly \$9 billion in September - roughly three times the amount that was withdrawn during the prior month. Canadian Mutual fund sales have suffered net outflows every month since April, and September's drop is also the second-biggest net loss since then (unitholders yanked \$10.4 billion out in June). But the data for September shows that investors sold their equity and fixed income funds in a large redemption binge that was based on the pretense of even worse declines in financial markets yet to come. Certainly, volatility has gripped markets as central bankers reiterated the narrative that higher interest rates are necessary to bring inflation back down to more normal levels, and worries deepened over the domestic economy heading towards a recession. But I smell opportunity...



[September was very likely the absolute worst time to exit one's position in things like equity mutual funds.]

Historically, retail mutual fund investors are an especially bad group when it comes to “timing” financial markets: they sell well after a decline and almost always have a strong proclivity towards those mutual funds that were *last year's* best performers. Many years ago, as an Assistant Portfolio Manager, I happened to attend the annual meeting of my then bank's mutual fund business. During that meeting, and I am not for a moment making this up, the President of the business actually encouraged Sales Directors to push whatever funds were last year's star performers. Think about that for a moment: a 51-year-old man, with years of experience, and a business degree told his staff to “pump” last year's best performing mutual funds!

So how confident am I that financial markets have bottomed?

To be honest, I'm fairly confident, but I know enough to know that every market cycle is unique in its own way. Similarly, every Investment Funds Institute of Canada (IFIC) report is unique in its own way too. Individual IFIC reports along with historical averages are a useful gauge for contextualizing where the current decline in retail fund investor appetite for risk is, and whether fund investors have missed the mark. The recent uptick in stocks, has clearly been driven by the expectation that central banks, which have been raising rates at the fastest clip since the 1980s to bring inflation under control, might now be nearing a pivot point, which too many may be missing.

Historically, this type of dislocation has ended poorly for investors because once you are out of the market, the big challenge becomes getting back in. Monetary policy-induced drops in stock prices lead to opportunities once policy has shifted towards easing, yet many investors sadly do not see this unfolding. We do not believe that is now, but we feel that it might be starting. Our team continues to be positioned with a defensive posture, but knows that by historical norms, the bear market of 2022 is likely in its late innings. As of this edition of *The Monthly*, the bear market of 2022 is well within historical norms. The average length of all declines of more than 15% is about 300 days and the current market is well within those confines as October concluded. With respect to magnitude, the average decline has been 29% and if you squint at the price chart of the SPX above, it will demonstrate that the index has declined by 24.3% from its early January peak through September 30. Of the 17 declines in the S&P 500 index since 1950, 14 have been at least 5% less or 5% more severe than the average decline of -28.7%.

Bear markets chaperoned by recessions have tended to be more menacing than declines that have occurred during non-recessionary periods. Of the 17 declines in the S&P 500 Index of at least -15%, nine have been accompanied by recessions. The average length of recessionary market declines has been about 420 days, which is indeed longer than the average for all 17 observations. At the same time, the average peak-trough decline in recessions has been 34.4%. In investments there is an expression: history doesn't repeat itself, but it often rhymes. And so, from a market perspective, while past declines may share certain commonalities, they aren't exactly the same.



Investor behavior, clearly, is much the same as in past cycles and we will have more to say on this in the third article. For the time being, take my advice that this is the market bottom with a grain of salt: it may not be. Yet, it has been my experience that during times like this, investors are better off reaching for their wallets than running for the hills.

Move along...nothing to “Xi” here...



President Xi Jinping’s third mandate included, among other things, a new cohort of officials who were handpicked by Xi himself. In fact, Mr. Xi made it abundantly clear that he was deeply involved in the selection process of choosing the new officials of the Politburo Standing Committee, China’s version of a governing council. A top criterion for selection to the committee was loyalty...to Mr. Xi. Criteria such as qualifications and on-the-job performance may have been factored into the selection process, but only if Mr. Xi felt they were relevant...meaning they weren’t. Another thing included in Xi’s third term was no limit on the number of mandates he can yet serve. In a move as predictable as the sun setting, Chinese officials naturally defended the move saying it would bring the presidency more in line with Xi’s other two main positions as party head and commander of the armed forces. State media ran more footage of Xi, more postage stamps with Xi’s image on them were printed out and more Chinese parents told their kids that they needed to be just like President Xi so that they can grow up to harness the power of China’s new silk road and enhance the economic power and political influence of the motherland.

Confounded by corruption...

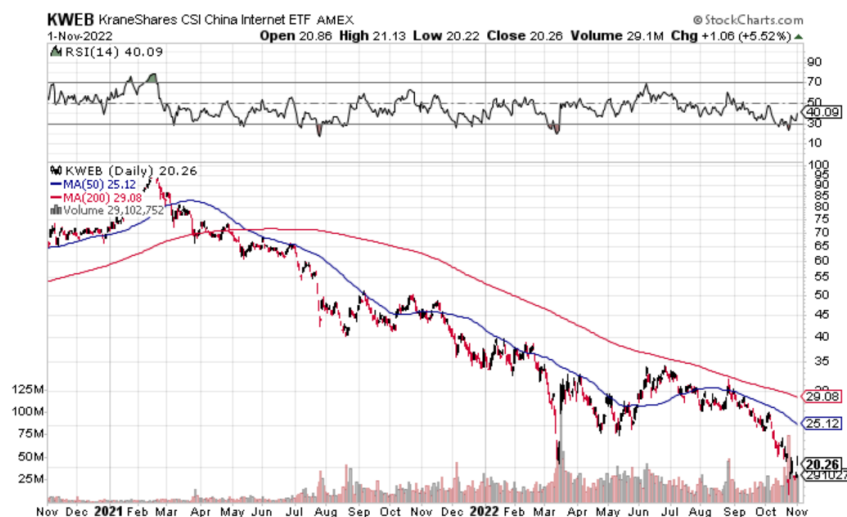
Xi is expected to double down on his years long campaign against corruption within the communist party to include all state employees through the creation of a new National Supervisory Commission, while continuing to pursue a more muscular foreign policy and policies to upgrade the slowing economy. Economic growth and social stability have allowed Xi to do pretty much whatever he wants when it comes to amending the constitution and carrying out actions that once were thought to be contentious.

Speaking of contentious, did you hear the story about the *former* President who disagreed with the standing President’s choice of committee members?



[“Get him out of here” “He did not agree with the names I wrote down in my red folder”.]

Watching guards semi-forcefully remove former President Hu Jintao from China’s great hall “of the people” was as disgusting as it was demoralizing, and investors it would seem had “Xi-een” enough. The basic thesis behind the huge selloff in Shanghai and Shenzhen reflects investor concerns that an even more powerful Xi will increasingly prioritize the state at the expense of the private sector. Pitching a different story to foreign investors doing business with China is going to be extremely challenging for Xi’s new economic team, and this has investors worried. For one thing, let’s say you happen to be the CEO of a mining giant that counts China as their most important clients, or the CFO of a multinational company that just invested billions of dollars setting up production facilities and supply chains in China. Your life just changed from doing business with the main driver of global growth for the past two decades to fear. China has unveiled new regulations and almost totalitarian crackdowns that have shaken huge swathes of the Chinese economy and can any of you remember the last time I wrote up a real estate investment held by our 360 Degree Realty Fund that was based in mainland China? Xi’s policies have caused major cracks to appear in the country’s property sector – which previously accounted for about 25 per cent of economic output. And the real estate developers seem to have gotten off easy. Have you taken a peek at Chinese internet stocks recently?



[The Kraneshares Chinese Internet stock ETF, which aims to track China-based companies tied to internet-related technologies got masacred two Mondays ago (down 17.5% in just one day!) and that is in addition to the 2-year crash the sector has faced.]

Indeed, Beijing has ground down China's large technology firms like Alibaba Group and Tencent Holdings abrasively chipping away at their Western world profit ambitions spurring layoffs and despair. And some of this is no doubt a retaliation to Mr. Biden's decision to introduce new policies that will frustrate Beijing's ability to kidnap advanced US technology, such as the kind used in semiconductor chips or complex manufacturing equipment that is required to make chips. But much of it is also no doubt a product of policies originating from deep within the inner workings of the Chinese ruling elite.

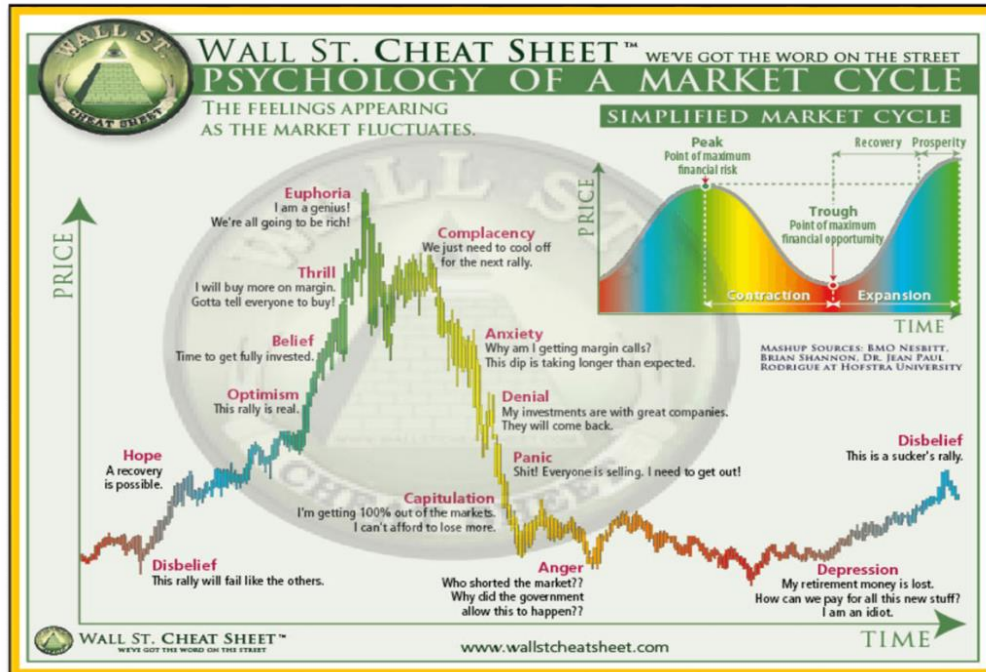


We spoke with one especially adept Chinese investment group out of Singapore on the 25th of October. The discussion was interesting in spite of my somewhat cheeky tone around Mr. Xi's self-coronation. China's overall economic sluggishness was the more proximate cause of comments around patience and timing. But clearly, this group "Xi-ees" things for what they are, and even though they point to "hard data" points in Chinese economy as reasons to hold off on investing for the time being, one cannot help but reckon that China has become less politically attractive too. When has surrounding yourself with diehard (some might say delusional) loyalists ever proven to be a sustainable long-term business strategy? Mr. Xi's advisors will never tell him the true state of the country because they will be too busy worrying about their own perceived loyalty rather than the Chinese people. Mr. Xi will undertake policies without a thorough understanding of their long-term implications, and this will undoubtedly lead to major potholes and that new silk road we mentioned a moment ago. Remember China's economy is already slipping, much like a set of old tires: at low speeds, and in ideal conditions, you'll barely notice the difference. But as road conditions change, and speeds begin to increase, that is when you begin to notice that you just aren't safe anymore. And that is how we now feel about Chinese investments.

About that "coronation" ...

In Mr. Xi's less than 2-hour address to congress he managed to reference the communist party 142 times, socialism 81 times and the Chinese economy not even once. The CEO and CFO we referenced earlier are no doubt aware that Xi's policies and obvious failure to reference the enormous economic elephant-in-the-room bode poorly for their companies, and no substantive capital investments should be made anytime soon. If anything, we seriously contemplate a world in which the corporate managers of large multinationals de-prioritize Chinese capital investments, viewing such moves as not only disadvantageous but potentially costly. Capital always flows to where it is treated the best. MacNicol portfolios are noticeably underweighted to China and the great Chinese people have nothing to do with this choice. Totalitarian autocracies offer us little to get excited over, but they might someday. If anything, regimes run under an iron fist often suffer spectacular moments of reckoning. Bill Browder's foray into Russia in the late 1990s is a good example of this. For the time being though, the MacNicol Investment Team believes that, when it comes to China, there is nothing really for investors to Xi here.

Behavioral Investing: Psychology of a market cycle



We include the above referenced Wall St. “Cheat Sheet” in many of our presentations to investors. We cannot take credit for creating the cheat sheet itself, but we do recognize its importance of it in investor education. And its importance is quite simply to help investors “check in” with the market as they “check in” with their emotions. It sounds pedantic, but financial markets don’t really behave the way shown in the graph above. Financial markets are dynamic and always a bit different depending on the state of the world around them. Yet, investor behavior on the other hand is more predictable. Let’s assume that you are someone who understands the value of saving for your future, and that you understand that in a (still) quite low interest rate environment, your options for growing your savings are limited. Chances are that the stock market is one of your go-to sources for wealth creation. Still, your emotions play tricks on you and these tricks can work against you when choosing a time to sell or reduce your reliance on stocks. Now one of the very first tricks the markets can play on you is capitalizing on the fact that investors generally tend to have a stronger emotional reaction to losing money than to gaining it. Losses hurt more than gains excite and investors will avoid losses, sometimes irrationally, in the hopes they will recover. Investors mostly feel that if they sell a loser *before* at least breaking even, they will feel regret and even shame. A second trick the market can play is separating you from your capital at precisely the wrong time. Selling long after a market decline has begun is the worst possible move you can make and amplified by the doubly tricky decision of having to “guess” when to get back into the market. Making mistakes when investing is part of the process (it happens all the time) but not having the courage to correct mistakes quickly unfortunately does not happen as often. Sadly, unconscious behavioral biases undermine our ability to make money on a consistent basis. Working with the MacNicol Investment Team can allow you focus on what you truly understand without being tricked by the market. Our independence and objectivity can help you make better investing decisions from a safe harbour by knowing you’re with someone whose looking out for your financial well-being.



Firm Wide News

In this month's webinar, the MacNicol investment team hosted members of Jurissa Financial for a special focus on Litigation Finance. [Click here to watch the webinar.](#)

MacNicol was also featured in the National Post recently. Published on November 3rd, David MacNicol gave some market insights for today's markets. [Click here to read the article.](#)

Ken Reid visited the D.C. area in October with some family, taking in the sights a month before U.S. Midterm Elections.