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 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.

"This idea that in order to make a decision you need to focus on the consequences, which you can know, rather than the probability, which you cannot know, is the central idea of uncertainty"

- Nassim Taleb, Author of *The Black Swan*

The Numbers:

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Index:		**2022 YTD:**
S&P/TSX:		- 0.45%
NASDAQ:		- 12.1%
Dow Jones:		- 6.7%
S&P500:		- 8.2%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	0.56%	0.35%
5-Year Bond:	1.50%	1.70%
10-Year Bond:	1.71%	1.79%
30-Year Bond:	2.01%	2.19%

Economic Data:

- Russia invades neighboring Ukraine
- Commodities sharply higher in February
- Oil prices soar on Russian invasion
- US Wholesale inventories for Feb at 0.8%
- US 4th quarter '21 GDP grew by 7%
- Bank of Canada raises rates 25 basis points
- Gold approaching $2,000 per ounce
- Equities globally were a mixed bag in February with large cap, resources laden indexes outperforming

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	25	30
P/B: Price-to-Book	4.4	4.2
P/S: Price-to-Sales	2.9	2.8
Yield: Dividend Yield	1.4%	1.5%

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

S&P/TSX Composite	-0.45%
NASDAQ	-12.1%
Dow Jones Industrials	-6.7%
S&P 500	-8.2%
Russel 2000 (Small Caps)	-12%
MSCI ACWI ex-USA	-5.8%
Crude Oil Spot (WTI)	30.6%
Gold Bullion ($US/Troy Ounce)	3.8%
SOX Semi-conductor Index	-16.3%
VIX Volatility Index	22.6%

Source: Canaccord Genuity Capital Markets & Thomson Reuters

Foreign Exchange – FX

As of Mar 14, 2022 11:00 AM	$ 5,000	Cdn		
Banks	Rate	**Buy USD**	**Cost**	**% Difference from Spot Rate**
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.2753	$ 3,921	$ 1	0.0%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.2878	$ 3,883	$ (37)	-1.0%
Raymond James	1.2900	$ 3,876	$ (44)	-1.1%
Royal Bank	1.3014	$ 3,842	$ (78)	-2.0%
Scotia	1.3105	$ 3,815	$ (105)	-2.7%
TD	1.3108	$ 3,814	$ (106)	-2.8%
Canadian Snowbird	1.2740	$ 3,925	$ 5	0.1%
Spot Rate	1.2755	$ 3,920	$ -	0.0%

We ain't comrades no more…

The situation in Ukraine is shocking, worrying and frankly disgusting. As someone with close family in Poland and cousins in Ukraine the invasion hit close to home. Short of offering my home as a place of refuge if Putin's troops make progress to the west, there was little I could do to reassure my family that things would be okay. But another family I have is our great clients here at MacNicol & Associates. By now, I have gotten to know most of you and I enjoy communicating with each of you through this publication. When I considered what might be going through your minds during this time, I felt better equipped to help. You see in general; the stock market doesn't really care that much about war. This might be as shocking for you to read as it was for me to write, but it is also true.

Geopolitical Events And Stock Market Reactions

		S&P 500 Index		Calendar Days To	
Market Shock Events	Event Date	One-Day	Total Drawdown	Bottom	Recovery
Iranian General Killed In Airstrike	1/3/2020	-0.7%	?	?	?
Saudi Aramco Drone Strike	9/14/2019	-0.3%	-4.0%	19	41
North Korea Missile Crisis	7/28/2017	-0.1%	-1.5%	14	36
Bombing of Syria	4/7/2017	-0.1%	-1.2%	7	18
Boston Marathon Bombing	4/15/2013	-2.3%	-3.0%	4	15
London Subway Bombing	7/5/2005	0.9%	0.0%	1	4
Madrid Bombing	3/11/2004	-1.5%	-2.9%	14	20
U.S. Terrorist Attacks	9/11/2001	-4.9%	-11.6%	11	31
Iraq's Invasion of Kuwait	8/2/1990	-1.1%	-16.9%	71	189
Reagan Shooting	3/30/1981	-0.3%	-0.3%	1	2
Yom Kippur War	10/6/1973	0.3%	-0.6%	5	6
Munich Olympics	9/5/1972	-0.3%	-4.3%	42	57
Tet Offensive	1/30/1968	-0.5%	-6.0%	36	65
Six-Day War	6/5/1967	-1.5%	-1.5%	1	2
Gulf of Tonkin Incident	8/2/1964	-0.2%	-2.2%	25	41
Kennedy Assassination	11/22/1963	-2.8%	-2.8%	1	1
Cuban Missile Crisis	10/16/1962	-0.3%	-6.6%	8	18
Suez Crisis	10/29/1956	0.3%	-1.5%	3	4
Hungarian Uprising	10/23/1956	-0.2%	-0.8%	3	4
N. Korean Invades S. Korea	6/25/1950	-5.4%	-12.9%	23	82
Pearl Harbor Attack	12/7/1941	-3.8%	-19.8%	143	307
Average		**-1.2%**	**-5.0%**	**22**	**47**

Source: LPL Research. S&P Dow Jones Indices. CFRA. 01/06/20

[Pearl Harbor was a sucker punch that left many investors with a black eye for the balance of 1941 and well into 1942. The one-day drawdown from Pearl Harbor was more than three times the average of the geopolitical events tracked by LDL Research, and total market

drawdown was nearly four times the average. The length of time it took markets to *recover* from the aftermath of Pearl Harbor was vastly longer than the average of the other geopolitical events.]

But the market isn't flippant or indifferent towards war either. When the prospect of a war catches everyone off-guard, stock markets will sell off dramatically. Some of you may say that Vladimir Putin's invasion of Ukraine was a "Black Swan event" that no one saw coming, and I would agree. But military and political experts have warned that this was coming. Perhaps this is why although initial accounts of the invasion did roil markets, a quick rebound was mounted. In contrast, the attack on Pearl Harbor by the Japanese in 1941 caused a far greater market malaise that lingered. North Korea's invasion of South Korea (June 25, 1950), Iraq's invasion of Kuwait in 1990 and September 11th also upended markets because little warning was offered in each case. In the present conflict, our investment team has added protection against steep market declines. We hope they don't happen, but if they do safeguards are in position. So, what might trigger an even deeper conflict if the present one wasn't truly a surprise? Let me walk you through a possible scenario…

The last Russian financial crisis [2014-2016] was caused by a sharp devaluation in the ruble during the second half of 2014. That was when investors began yanking money out of Russia for Putin's role in Crimea and the war in Donbas. The sanctions that followed hammered confidence in Russia's financial system and along with it the value of the ruble. OPEC had also decided in late 2014 that global oil prices were too high and new supplies needed to come online. Russia's ability to make money was severely injured and this made the impact of sanctions that much worse. Sanctions began with travel bans and the shredding of investment contracts but eventually spread to Russia being kicked off the European Council. The Americans banned certain Russian individuals from traveling to or doing business in the United States. Two major Russian energy firms Rosneft and Novatek, as well as two major Russian banks Gazprombank and Vnesheconombank were also banned from doing business of any kind with America. Other NATO member countries joined in on the action effectively choking off the ruble from the ability to lure foreign capital and make up for lost oil revenues. We believe the same might be happening again today.

[European Commission President Ursula von der Leyen announced powerful measures against Russia. In particular, the EU

will a) remove a certain number of larger Russian banks from Swift and b) freeze the assets of Russia's central bank.]

Direct sanctions against a nation's central bank are measures so crippling they could in theory inflict more damage than Western investors might realize. Past sanctions simply punished the Russian financial system, whereas current sanctions could bankrupt the entire Russian financial system and render the ruble worthless. As this is heavy stuff at a truly tense time in world history, perhaps a drink will help…

[Smirnoff Vodka has a long history even if the company is today owned by alcohol juggernaut Diageo Group. A publicly traded parent means that every ounce of Vodka is accounted for even if not every ounce is produced in Russia. But, to illustrate the sobering reality of the ruble's future, I invite you to assume that all Smirnoff gets made in Russia in the paragraph that follows.]

History has it that the Smirnoff brand began with a vodka distillery founded by Pyotr Arsenievich Smirnov in Moscow. These days, Smirnoff is owned by Diageo Group and the vodka itself is produced where it will make the most money not nostalgia. But let's assume Smirnoff sources water from the UK, plants from Japan, legal and marketing services from the United States, distillation equipment from Germany and the bottles, caps and labels from China. Finally, let's assume Smirnoff <u>only</u> sells its vodka to Russians in Russia.

A business that earns money in rubles but incurs costs in pounds, yen, dollars, euros and yuan, is one in which the owner could use a Russian bank to convert rubles into the other currencies or simply set up an account at a Russian bank denominated in these different currencies. Since selling rubles to acquire units of another currency occurs through computers that "credit" or "debit" electronic ledgers at banks, the deposit of rubles at one bank are electronically offset by the arrival of the foreign currency at the other bank. Rarely does any physical money change hands because for every physical ruble circulating throughout the Russian financial system, there are private sector claims on Russian banks five times that amount.

Russia's state-owned companies purportedly have even larger claims on the country's foreign currency reserves, so let's simply say double the private sector's claim plus some more. So despite the relative scarcity of actual rubles in Russia, each one of these computerized "debits" and "credits" can continue to happen because Russians, particularly post-communist era vodka lovers have faith that their bank could pay out foreign cash if demanded. However, if every Russian with a bank account at a Russian bank showed up demanding pounds, yen, dollars, euros and yuans all at the same time, the result would be a classic bank run. Accept Russians wouldn't do that because they know that if there was a real problem, the *central bank* of Russia would supply the needed units of foreign currencies to local banks. Russia's central bank supposedly has over $630 billion in reserves on hand for an emergency. And if a situation were to arise the central bank would draw on its reserves and wire the funds to the local banks that most Russians use, and each account holder could be paid in full the currency of their choosing. Wouldn't they?

[Many Russians believe there is $630 billion in foreign currency reserves locked in a vault in this building in Moscow.]

Yes, $630 billion worth of dollars, euros, pounds and yen is a lot. But is all that money *really* locked in a vault inside the central bank of Russia? Russia may theoretically "own" all that money, but it does not control it. Most of that money is controlled by other foreign central banks. The Russian reserve figure only exists as a notional amount, which means the only reason, or perhaps way, in which these monies "exist" is because someone at the Federal Reserve or the European Central Bank or the Bank of England or Japan updates a computer to suggest that their bank owes the Russian central bank an amount of these other currencies. The "reserves" the Russian central bank says it has are little more than records that acknowledge the existence of a debt. Western central banks then collectively owe the Russian central bank hundreds of billions of dollars. At this point, you may be thinking that our Smirnoff owner can rest easy since this is a situation that actually favors the Russians. But the truth is, it doesn't. If I owe the Toronto-Dominion Bank one million dollars, then I have a problem. If I owe the Toronto-Dominion Bank one hundred *million* dollars, the Toronto-Dominion bank has a problem. A debtor, any debtor, can wreak havoc on a lender by simply not paying the debt when demanded. Smirnoff might have hoped to draw on reserves of foreign currencies who's ultimate, end-source of funding are Western central banks. The bank of Russia would call up the US Federal Reserve or the European Central Bank and ask that a couple hundred million US dollars or euros be credited to the accounts at various private Russian banks for use by the owners of Smirnoff. But all of this requires the cooperation of the Fed or the European Central Bank, and both institutions plus several more might simply say "*We ain't comrades no more*". This is how the world will freeze Russia's financial system. No electronic transfers of dollars or euros from other banks means the central bank of Russia would not be able to credit these payments to regional banks for use by individual Russian business owners. The ramifications of such actions are mind boggling because the *entire* Russian financial system could literally get choked out. Now in case you are thinking to yourself "*Impossible, they'll never resort to that…",* recall that in 1979 the US Fed did exactly that, to Iran. Persian revolutionaries captured US diplomats as hostages that year and when diplomacy failed, Iran's access to US dollar reserves was turned off. However, in 1979 Iran was effectively printing money through oil sales and was able to withstand direct central bank intervention. Russia’s war with Ukraine is proving to be costly and it will soon need access to reserves, badly. And this is why, shortly, every person in Russia will be one step closer to default. However, prior to any of that happening, all parties involved would have to panic.

In our version of Smirnoff, the company owners would literally have to race down to their local bank, empty their dollar or euro accounts and store the money in a vault or safe. While the malaise would be unfolding, the regional Russian banks would call the Russian central bank to say they need money, and the Russian central bank would respond by saying they don’t have any money.

With the Russian central bank’s foreign exchange accounts frozen the ruble would cease to a convertible or interchangeable currency and good for little more than the exchange of goods or services purely within Russia. The ruble’s ability to buy goods, or services or really on international markets would be nil and this would result in the entire Russian economy collapsing. Russia is self-sufficient since it can produce basic commodities such as oil & gas, certain type of metals but most everything else its citizens use comes from someplace else. Thus, a connection to a central bank that is itself connected to other central banks around the world on which it has a good working relationship is vital.

Ahhh but Joseph, you have forgotten about Russia’s gold…

[Russia's official gold reserves put it on par with countries like France. Unofficially? Je ne sais pas.]

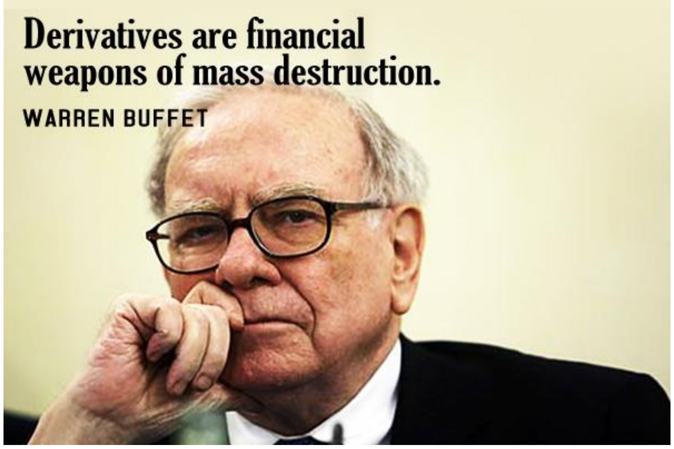
Indeed, Russia does have quite a lot of gold. Real gold, actual gold. And this means that in an absolute dire situation, the country could – in theory – sell its gold or pledge it as collateral. But who would loan Russia the money? Countries caught doing business with Russia would themselves be slapped with sanctions purely for consorting with an enemy. And nations daft enough to offer the Russians a helping hand could not do so in a meaningful way. Burundi, Burma, the Democratic Republic of Congo simply do not have enough money to send tens of billions of dollars or euros over to Russia in exchange for gold they can do little with.

Myanmar's entire GPD is the equivalent of US $80 billion. There is one country with the money and foreign relations ambitions that would help out the Russians: China.

["You is got my back…da?" "It's complicated Vlad…"]

First off, China could easily wire a hundred billion dollars to the central bank of Russia in exchange for roughly 1,600 tons of bullion. But that doesn't mean they would. President Xi would likely demand that any gold purchased from the Russians be done at a huge discount to spot pricing. And would President Xi approve of 1,600 tons of gold to remain in a Russian vault while billions of dollars leave Chinese coffers? I don't think so.

So, what then, place 1,600 tons of gold on a train or on some military cargo jets? But what would such a move even accomplish aside from damaging China's reputation globally? Only central banks of the west can make this happen.



[So are central banks.]

Penalizing a rogue nation's financial system is one thing, crushing it entirely is another. Western world leaders ought to think hard about vaporizing Russia's economy as the moves could punish law abiding Russians while making their leader more erratic. The goal of the world is to de-escalate Russia's aggressive and potentially illegal behavior, backing Putin into a corner could lead to dangerous and irrational desperate measures.

So, could the Western world use their central banks to rachet up pressure on the Russians economy without crushing it completely? Conceivably. As with a child who is bad at managing money, an allowance of "x" dollars per month could form a sort of stipend that could keep the Russian financial system limping along. And military spending - when the nation doesn't have enough food to eat – would thrust Putin's maniacal ambitions on every member of Russian society. Putin's cronies, uber wealthy oligarchs and ordinary Russians in the street would all learn that Russia needs access to the world's other currencies more than the Europe needs its fuel. Russia's economy is about to spiral out of control because of the choice one man made, but hey like I said earlier "*we ain't comrades no more*".

Open for business…and scrutiny…

Decentralized autonomous organizations or DAOs are a novel type of corporate organizational structure operated through interconnected contracts. DAOs are the antithesis of the centralized corporate structures since a DAO is self-governing. The transaction history and programmed rules of a DAO are stored on the blockchain, which boosts the transparency and immutability of the DAO. The blockchain is a mutually shared ledger that logs interactions among users [mainly transactions] and the associated assets in a business network. As discussed in an earlier edition of *The Monthly*, the assets themselves can be tangible such as the treasures belonging to the family of Prince Lobkowicz of the Czech Republic or a car, a baseball card collection or even the locks of hair you trim from your child's first ever haircut. The assets can also be intangible such as patents, copyrights or branding rights. Anything of value can be tracked and traded on a blockchain network, reducing risk, and cutting costs for all involved. Where the "block" in blockchain comes from is the individual list of digital records, which are called blocks, and which are linked together using cryptography. Each block contains a cryptographic hash of the prior block, which acts as a timestamp, and transaction data. The timestamp confirms that the transaction existed when the block was published to get into its hash. As blocks each contain information about the block before it, they form a chain, with each additional block reinforcing the ones before it. Therefore, blockchains are less likely to be manipulated because a *retroactive* change is not possible without altering all subsequent blocks. While one person or entity must form the DAO, they do not retain sole control over the DAO. The DAO can run without a traditional business structure. All “members” of the DAO have a say in the actions of the organization, which differs from more centralized organizations, such as a bank. Business decisions at a bank are made at the top by a CEO or CFO and distributed down the chain of command under the oversight of a board of directors.

Ukraine has been establishing itself as the main decentralized finance hub of not just Europe but the entire eastern world. The reasons behind Ukraine’s status as a centralized hub for decentralized finance are simple: low taxes, light regulation, and a surplus of highly talented engineers. The daily volume of cryptocurrency transactions stands at around $150 million—exceeding the volume of interbank exchanges in fiat currency, the hryvnia. Ukraine also does not have a robust stock market and many citizens with money prefer real estate. So, cryptocurrencies are an attractive alternative. But due to the invasion, it has been used for humanitarian purposes, with people across the world sending crypto to the Ukrainian government and nongovernmental organizations

Cryptocurrencies may help Russia and its billionaires blunt the impact of western sanctions. The sanctions aim to limit Russia's ability to do business in dollars and other major international currencies but might carry less weight in a country that is taking steps to legalize cryptocurrencies and where the digital assets are already widely owned. Typically, nations employ physical workarounds to avoid sanctions, such as Venezuela and North Korea's use of ocean-going fuel transfers. Sanctions imposed on companies and individuals by the U.S. and its allies could essentially close them out of the West. Billionaires, some of whom have already been targeted, potentially stand to circumvent those penalties if they choose to use crypto, which uses blockchain technology to keep transactions anonymous.

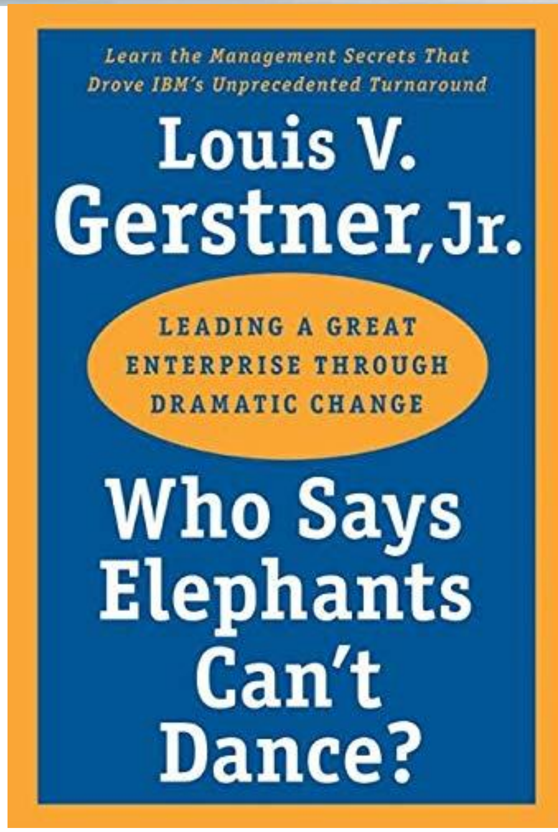
We have long maintained that crypto is here to stay even though 90% of the applications out today likely won't be around in 5 years. In some ways, DAO cryptocurrencies are about to face another significant test. And if they can rule out evil Russians while remaining open for business, we feel this is a test they will pass.

The psychology of betrayal…

Have you ever been sucker punched before? If you have, then you know that the worst thing about being sucker punched is not having the opportunity to brace yourself beforehand. A sucker punch can be literal or figurative and which one hurts more depends mostly on context. One figurative sucker punch comes in the form of betrayal, which can easily flip your life upside when things seem to be sailing smoothly. I have been lucky because treachery hasn't been a major part of my life. But that doesn't mean I haven't felt betrayed before.

One energy company I owned prior to working for MacNicol & Associates had a CEO that said all the right things and made me feel really comfortable in my decision to hold shares of his company's stock. This was particularly true during that really gnarly patch in the Oil & Gas sector following OPECs decision to not curtail production volumes in 2014. I wondered how this company was able to pay a dividend when oil prices were down. Energy companies are cyclical you see, they *can* pay a dividend when times are good, but they can also suspend dividends when things go south. My first clue that things were going south was the company's share price. The decline caused the dividend yield, which is a percentage and usually a fixed rate [hopefully!] to skyrocket from 5% to 12% and this was the stock market telling me that the dividend was NOT sustainable. Still, the company CEO assured all of us that the dividend was safe…until one day it was cut. And so, I hope you will agree that betrayal can be traumatic. Fortunately, Nafeesah Allen, Ph.D., penned a 2021 article entitled *What is Betrayal Trauma: how to recognize and heal it*, which offers us guidance to help us not only realize that betrayal is trauma but what we should do about it. Dr. Allen's article has parallels to investing.

Getting burned by some "hot stock tip" or wrapped up in the latest "pump and dump" scam can make you feel betrayed. But in general, I think most of you will understand that getting stock tips from your next-door neighbor or rolling the dice on penny stocks doesn't work. On the other hand, feeling betrayed by a supposedly high-quality company can feel like betrayal, especially if money was lost. IBM is a good example of a "quality" company because by-and-large, it is. But there were several periods during IBMs history when things didn't look so good. And if you think "Big Blue" was spared the from the big tech meltdown in the early 2000s, you'd be mistaken. IBMs share price lost half of its value from April 1999 to April of 2002.



As a matter of fact, the first three quarters of 2002 were a complete disaster for IBM stock and many investors probably did feel betrayed. Elephants probably can dance, just not very well.

But as Dr. Allen references in her article, one of the best ways to deal with trauma is to acknowledge that it exists and talk about it. At MacNicol and Associates we aren't here to judge we are here to help. So, if you have felt betrayed by an investment in the past, come in for a no obligation review. We will take the time to learn about you and your past investments. Together we set you back on a path forward, even if that ultimately means hanging on.

The MacNicol Investment Team

Firm Wide News

The MacNicol Investment Team implemented project black swan; a “fire insurance fund” intended to provide added protection during these highly uncertain times.

Short https://vimeo.com/676382367/0657236b8d

Long https://vimeo.com/676402601/7a606be327

As always, if you have any questions, please give us a call or send an email.

Happy March Break to all!
We hope you are able to get away a travel.

MacNicol & Associates Asset Management Inc.
March 2022