July 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.

"The only useful thing banks have invented in 20 years is the ATM."

- US Fed Chair Paul Volcker

The Numbers:

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Index:		**2022 YTD:**
S&P/TSX:		-11.3%
NASDAQ:		-28.8%
Dow Jones:		-14.4%
S&P500:		- 19.7%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	2.11%	1.73%
5-Year Bond:	2.94%	2.82%
10-Year Bond:	3.07%	2.82%
30-Year Bond:	3.02%	3.03%

Economic Data:

- Stock market rout accelerates in June
- Oil lower by 4% in June
- Canadian consumers and businesses feel inflation will be around for a while yet
- US unemployment fell to 3.6% during the first half of 2022
- The US and China hold talks aimed at the huge challenges facing the global economy with some forecasting the easing of tariffs

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	19	26
P/B: Price-to-Book	3.8	4.4
P/S: Price-to-Sales	2.4	2.9
Yield: Dividend Yield	1.6%	1.6%

2022 Year to Date Performance, by Sector: June 30th, 2022

S&P/TSX Composite	-11.3%
NASDAQ	-28.8%
Dow Jones Industrials	-14.4%
S&P 500	-19.7%
Russel 2000 (Small Caps)	-24.1%
MSCI ACWI ex-USA	-17.7%
Crude Oil Spot (WTI)	57.5%
Gold Bullion ($US/Troy Ounce)	-2.20%
SOX Semi-conductor Index	-37.7%
VIX Volatility Index	66.7%

Source: Canaccord Genuity Capital Markets & Thomson Reuters

Foreign Exchange - FX

As of June 13, 12:00 pm	$5,000	Cdn		
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.2943	$3,863	$3	0.1%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.3355	$3,744	$(116)	-3.1%
Raymond James	1.3050	$3,831	$(29)	-0.8%
Royal Bank	1.3329	$3,751	$(109)	-2.9%
Scotia	1.3358	$3,743	$(117)	-3.1%
TD	1.3323	$3,753	$(107)	-2.9%
Canadian Snowbird	1.2983	$3,851	$(9)	-0.2%
Spot Rate	1.2952	$3,860	$-	0.0%

No love lost…

We love a good macroeconomic narrative; the trouble is there isn't one right now. The first half of 2022 is one that most investors would rather forget. Our investment stance over the past 12-months has been cautious and consistent with our view that inflation is pummeling consumers and businesses. Higher prices are a huge problem, and financial markets worry about whether policy makers can reign in what is now *runaway* inflation. The impact of higher inflation and higher rates was relentless and took no prisoners during the first half of the year. Fixed income investors experienced the reality of noticeable reductions in the capital of various bond funds and partnerships. The first half was also dreadful for stocks, which careened lower and paused just long enough in May to set up for further losses as the second quarter ended. Experienced investors underestimated fixed income position volatility while newer investors have now given up the gains they made in the stock market from November 2020 until August 2021.

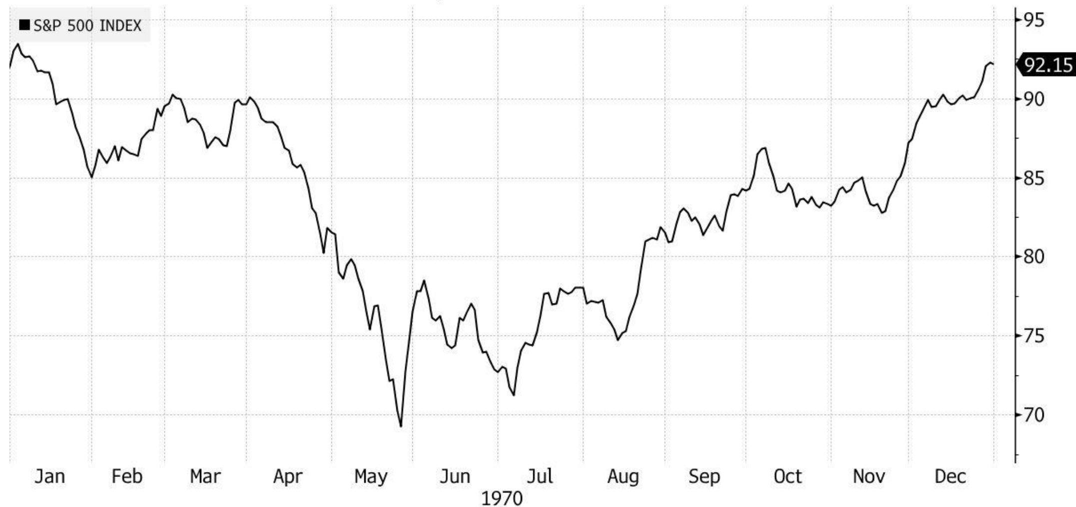
More broadly, 2022 has not been a good year for the traditional "balanced" investor, passive indexers, or growth investors but there was some budding good news as the first half ended. Investors are doing a good job of resisting the urge to sell, which is a good thing. Based on certain metrics, the market is - if anything - cheap. For instance, the percentage of stocks on the NASDAQ above the 200-day moving average has dipped below 15%. The NYSE is roughly as cheap; it dipped below 16% recently. The stock market last washed out like this 2008, but rewarded investors who stayed put or snapped up bargains.

So, is now a good time to get into stocks?

We would say yes. Economic expansions do not die of old age they are reined in by policy makers and eventually, the rate hike rhetoric will moderate and becomes more neutral. Jerome Powell last said that running the Federal Funds rate above target may be appropriate but, as always, data dependent. Investors with elevated cash levels should begin hunting for deals as the initial shock of the latest tapper tantrum is probably over.

Unfortunately, we cannot say the same about local real estate. Domestic residential lending products have been repriced and the qualifications for taking out a new mortgage are more stringent, and now include stipulations like being able to support an interest rate of 7%. Ontario's top five-year fixed rate is 4.24% so in certain situations stocks and US real estate represent better options.

Historical precedents such as in 1970 are a good one for stocks. The economy struggled in 1970 due to higher inflation as is the case today, but also due to the costs of the Vietnam War and increased foreign competition. Today's economy is dragged down by supply chain woes that monetary policy is not equipped to address. Nonetheless, the S&P500 had a dreadful second quarter drop in 1970 yet spent the rest of that year reversing first half losses, and we believe a melt up is brewing this year too.



The S&P500 broke down below 3,800 points, a level many technicians regard as significant to those concerned about more problems in stocks. However, the selling pressure was not as voluminous as the last breakdown in the second and third week of June suggesting seller fatigue. And late June experienced the more choreographed sell off you see in quarter-ending “window dressing”. Equity funds took advantage of the last chance to cleanse their books of stocks they did not want to be holding which added to volatility. Because that selling pressure is now gone, and because by-and-large stocks are now cheap, investors will approach stocks with less trepidation.

The opportunity set for equity investors is narrow but there if you look hard enough. Canadian equities still outperform their US counterparts in 2022 due to higher materials and energy exposure. But US markets offer pockets of value that many Canadians could miss out on. US value stocks in particular represent attractive opportunities in healthcare stocks which were higher in the final two weeks of June.

And finally Asian equities, as we will get to in a moment, look to have bottomed out as restrictions in Shanghai and Beijing are being eased in one of the more accommodative monetary environments in the world. The first half of 2022 was not positive for stocks or bonds and the expectation for higher near-term interest rates makes taking a position in bonds challenging. Equities have been volatile too but offer clearer signals of attractive valuations, seller fatigue, a bottoming process, and specific areas we can direct investors too. It is time to buy stocks, just be sure to take a careful look at what you are buying.

Asian Market Update

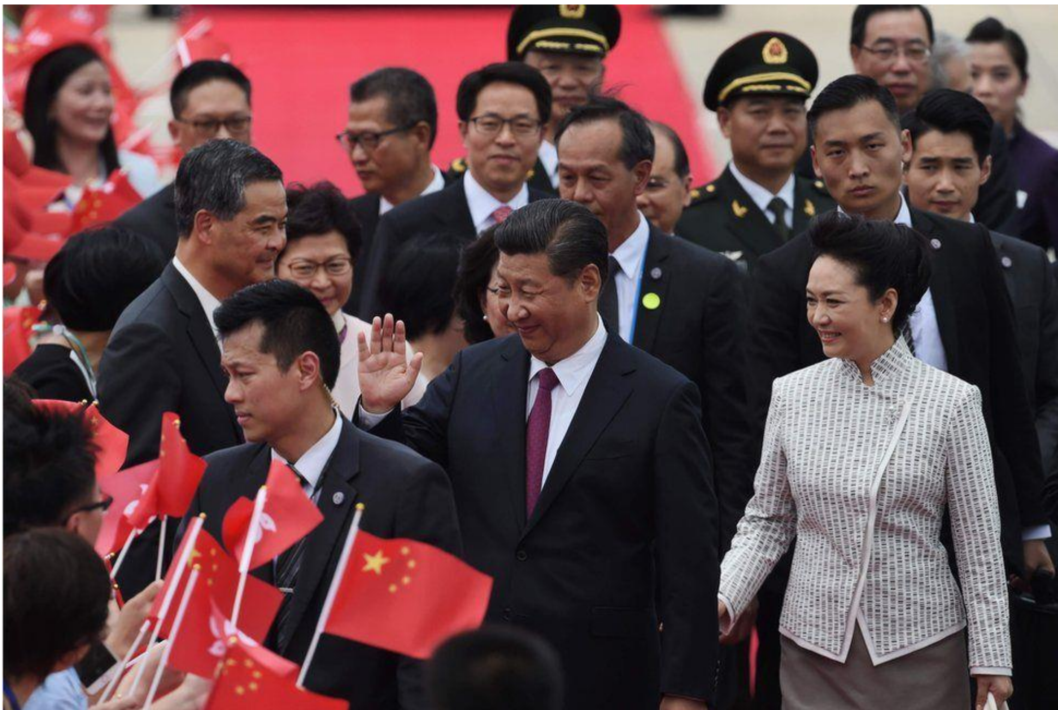
As 2022 began, the Chinese credit market exhibited severe challenges on lock down fears. Some of the declines in Chinese corporate high yield issuers were more extreme than those seen during the 2008 financial crisis or during the recent Evergrande real estate crisis. Property debt repayment ability and transparency among Chinese developers continues to be the main risks in investing in Chinese real estate. But liquidity in the sector has increased recently. China's Shenzhen SEZ Construction and Development Group, a state-owned enterprise, announced they will be making a US$245 million equity investment in China South City as a developer and operator of large scale, integrated logistics and trader centers in China.

[China South City Shenzhen is the South City Development Group's first project, strategically located at the heart of the Pearl River Delta region amid an extensive transportation network. The $245 million equity investment stops some slippage in Chinese real estate. However, we are not presently investing in Chinese real estate, nor were we in the past 5-years, nor do we have plans of adding to Chinese real estate in the future.]

New, large, shareholders can repair beaten up credit profiles and improve access to capital. But for us, Chinese real estate is a high-risk, mixed bag that does not provide the consistency of a US growth market approach to real estate. For example, China's Sunac and Fortune Land Development experienced mark-to-market losses during the first quarter whereas the 360 Degree fund was higher by 5.2% over an identical period. Chinese real estate is ultimately an asset class that is difficult for us get our heads around, but Chinese stocks may offer good value in what is an economy that continues to put out positive numbers in certain areas.

Industrial production was higher by 0.7% in May compared to the year ago period. Analysts expected a 0.7% drop. Chinese retail sales also fell less than expected, to 6.7% in May from a year ago. Analysts expected a declined by 7.1%. And Goldman Sachs forecasts that Chinese household spending will increase by 4.5% during the second half of the year compared to the same period in 2021. Any positives no matter how tiny suggest that the production side of China's economy was less interrupted by COVID and reasonably strong on the manufacturing side. China is also more accommodative when it comes to monetary policy. The People's Bank of China recently upgraded a currency facility it has with Hong Kong to a permanent agreement and expanded the size to 800 billion yuan from 500 billion yuan. The agreement, signed by the People's Bank of China (PBOC) and the Hong Kong Monetary Authority, is China's first standing swap agreement. The PBOC said the upgraded agreement could provide long-term liquidity support to the Hong Kong market, help stabilize market expectations, and promote the development of Hong Kong's offshore yuan market.

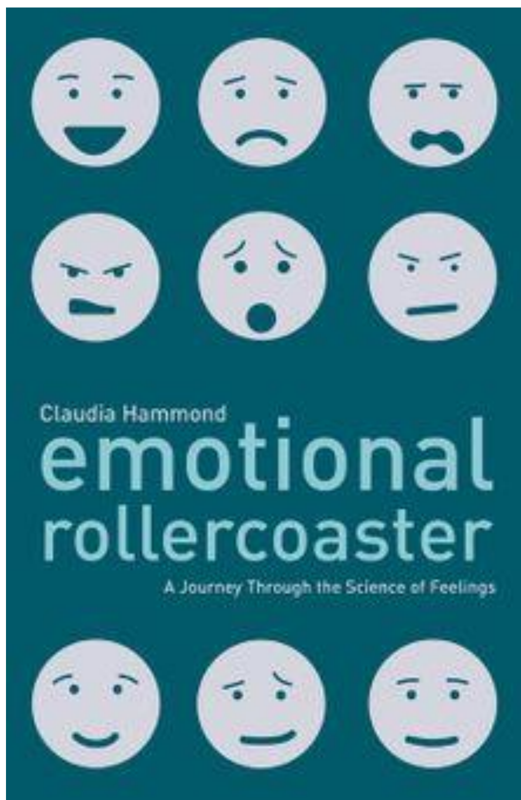
President Xi visited Hong Kong earlier and this does not happen often. The media is of course capturing Xi's COVID scar however the more salient news to investors is Xi's support of Hong Kong as an international finance hub. The political pageantry around Xi's visit was a little silly; the phrase "return to the motherland" was used but the fact is this permanent currency facility further integrated mainland China into international financial markets which could attract investors.



An economy that continues to power through COVID and financial reporting opaqueness while still offering monetary support and better access to global liquidity position Chinese stocks as a possible back up option to equities in stagnating or receding economies.

Behavioral Investing

Emotional Rollercoaster



Claudia Hammond was born in 1971 and holds Bachelors and Masters degrees in Applied Psychology. She regularly presents her own distinctive perspectives on psychology on Radio 4. Hammond's past works include *Brain Waves*, *Raging Hormones*, *The ABC of Vitamins* and *Sense the Difference*. Hammond is also a successful author. In *Emotional Rollercoaster* Hammond takes readers on a lively and entertaining read through the myriad of emotions humans can experience, and the connections to the bear market of 2022 to me seem obvious. Bear markets have technical characteristics that frequently omit impacts to investor psychology. This is why applying Hammond's approach to how bear markets can make you *feel* can be so effective.

In a bear market it can be challenging to lift yourself above pervasive negativity. Portfolios tend to decline in value when markets are weak, and the media will tend to sensationalize their already incessant flow of information when markets struggle for traction. The ability to make consistent choices then can be overwhelmed by negative emotions. There are three ways the emotions experienced during a bear market can lead investors astray. First, our feelings about investing are more adversely impacted by bad news than propped up by good news. Second, we tend to scoff at the notion that negativity will impact us emotionally until it does. And finally, the feeling of fear and a heightened sense of risk will be amplified by the behavior of other people; this is why I always avoided hanging out with nervous CFA candidates prior to the am and pm administrations of the program's three tests. Anxiety and panic in others can create a negative feedback loop that can cause you to panic "just because". Bear markets are a breeding ground for rash investment decisions made in great hast. So, stick to the facts and make inferences from there.

No emotions in probability theory…

Although investors are not renowned for their consistent use of probabilities, strong emotions can make this problem worse. In 2002, Cass Sunstein wrote a paper on probability neglect, in which he argued that when powerful feelings are sparked humans tend to disregard probabilities. Sunstein offers the example of a study where participants were asked about their *willingness* to pay to eliminate the risk of severe illness. When severe illness was **described** in a vivid and gruesome way, the impact of a tenfold change in its likelihood on the willingness to pay to remove the risk was markedly less than when the disease was described in non-emotive terms. Provoking emotion just by itself rendered individuals far less sensitive to changes in probability. In a bear market fears can be augmented by the inevitably colourful stories of how much worse things will get. Our ability to reasonably assess the likelihood of future developments then can be compromised.

How can we dampen the influence of emotions?

One way that seems to work well is collaborating with us. A time-tested, disciplined investment process is something that can be used to decentralize your fears and keep you connected to your long-term investment plan. Our work is hardly a failsafe solution to diminishing the impact of emotions can have but it can prevent you from making costly mistakes. It is common for investors to be advised about the plausibility of losses over an investing cycle; for example, a typical equity portfolio can experience drawdowns of at least 20% several times during a particular investment time horizon. But this data point offers little on how experiencing it might feel. Investors need to prepare as best they can for the emotional realities of losses and be guided as to what a period of severe decline might mean about the broad backdrop, and that's why we ask many questions about your situation and how we can build a customized portfolio that's right for you. As the first part of 2022 was a challenging market environment, the main questions investors should ask is what can they do now to ward off the dangers of emotion-laden decision making? Hammond suggests removing yourself from emotional stimulus. Bloomberg and Google Finance are two such stimulants. Long-term investors should stop doing anything that provokes a short-term emotional response. Second, resist the urge to make in-the-moment investment decisions, as these are likely to be driven by how we feel at that specific point in time. We should always step away and hold off from making a decision and reflect on it outside of a particularly nasty stretch in the markets. We can help acquiesce your concerns with data and perspective. The ride could still be bumpy yet, but at least you'll have someone experienced at your side

Firm Wide News

Joseph Pochodyniak and David MacNicol presented to the Association of Canadian Pension Management in June. The topic was " A Principle – Based Approach to Real Estate Developments." Should you wish to hear more about this, please reach out to us and let us know.

MacNicol & Associates Asset Management was referenced in a Globe and Mail article by Ivey School of Business Professor George Athanassakos. Dr. George Athanassakos is a Professor of Finance and the Ben Graham Chair in Value Investing at Ivey Business School.

You can find the link to the article here:

https://www.theglobeandmail.com/investing/investment-ideas/article-why-the-outlook-for-stocks-bonds-and-real-estate-markets-have-rarely/