August 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.

"Too many people spend money they earned. To buy things they don't want. To impress people that they don't like."

- Will Rogers

The Numbers:

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Index:		**2022 YTD:**
S&P/TSX:		- 8.32%
NASDAQ:		- 22.3%
Dow Jones:		- 10.5%
S&P500:		- 14.6%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	2.67%	2.50%
5-Year Bond:	2.66%	2.78%
10-Year Bond:	2.65%	2.70%
30-Year Bond:	2.78%	2.97%

Economic Data:

- Stocks broadly higher in July
- Crude oil gives back nearly 11% in July
- Gold rebounds towards the start of August
- BITCOIN up 18% in July following a major short circuit in May and June
- US economy enters technical recession
- Canada's GDP registers no growth in May
- Natural gas higher again in July this time by 24%
- CAD and US 10-year bonds higher in July but still off 8% and 7% respectively YTD

Valuation Measures: S&P 500 Index

Valuation Measure	Latest	1-year ago
P/E: Price-to-Earnings	21	26
P/B: Price-to-Book	4.0	4.4
P/S: Price-to-Sales	2.6	2.9
Yield: Dividend Yield	1.5%	1.4%

2022 Year to Date Performance, by Sector: July 29th , 2022

S&P/TSX Composite	-8.32%
NASDAQ	-22.3%
Dow Jones Industrials	-10.5%
S&P 500	-14.6%
Russel 2000 (Small Caps)	-12%
MSCI ACWI ex-USA	-15.6%
Crude Oil Spot (WTI)	44.5%
Gold Bullion ($US/Troy Ounce)	-4.9%
SOX Semi-conductor Index	-18.7%
VIX Volatility Index	-9.76%

Source: Canaccord Genuity Capital Markets & Thomson Reuters

Foreign Exchange - FX

As of August 3, 1:00 PM	$5,000	Cdn		
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.2859	$3,888	$(1)	0.0%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.3215	$3,784	$(106)	-2.8%
Raymond James	1.2990	$3,849	$(40)	-1.0%
Royal Bank	1.3141	$3,805	$(84)	-2.2%
Scotia	1.3229	$3,780	$(110)	-2.9%
TD	1.3217	$3,783	$(106)	-2.8%
Canadian Snowbird	1.2973	$3,854	$(35)	-0.9%
Spot Rate	1.2856	$3,889	$-	0.0%

Not in a recession… "wink-wink, nudge-nudge"…

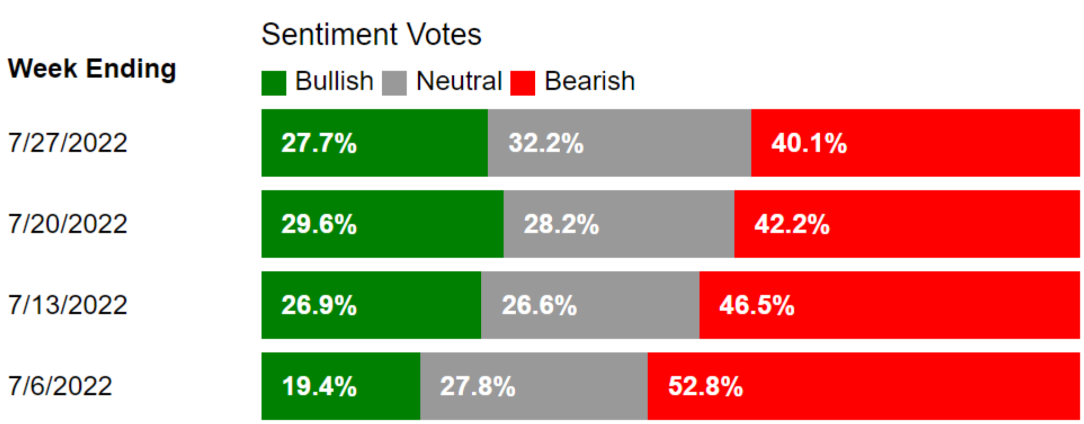
Bank of Canada Governor Tiff Macklem is eminently qualified to lead our nation's Central Bank, but his job just got a lot tougher. Though not technically in a recession, our economy did not grow whatsoever in May according to figures from Statistics Canada. Slowing growth places Governor Macklem's more forceful approach towards inflation at the juxtaposition of a more plodding Canadian economy and one that continues to struggle with outrageous inflationary pressures.

[Eminently qualified, amply paid. Macklem's official compensation at the Bank of Canada is public knowledge and listed as somewhere between $457,300 and $538,000. Of all the challenges Macklem faces, political inquiries into his credibility could be the most daunting. Besides, what does anyone making half a million per year really know about inflation?]

Canada's real GDP was unchanged in May after a 0.3% expansion in April. Growth in service industries was offset by a decline in goods-producing industries. With growth slowing down as businesses continue to face supply constraints and labor shortages, and consumers beginning to buckle under the weight of not only more expensive food, fuel and rents but also higher carrying costs for debt. Indeed, the Canadian economy could be maxed out.

[Labor problems in Canada are easy to see, just go to your local airport.]

In the United States, our friends there are technically already in a recession and our concern is that investors in US equities may not have noticed. The American economy contracted for a second consecutive quarter, and this has magnified concerns that high inflation and shrinking demand could drag the country into a more protracted recession than investors may suspect. US GDP fell at an annualized rate of 0.9% through the three-month period that ended in June whereas most economists expected growth to hit a 0.5% pace. The American story is then one of less is less, with the economy *continuing* to shrink after the 1.6% contraction observed in the first quarter, unless one examines complacency where less is more. The recovery from the COVID recession has been slower this year and impeded by lingering symptoms like a hacking supply-chain cough and weaker spending. Yet the appeal of US equities appears to be following its own logic:

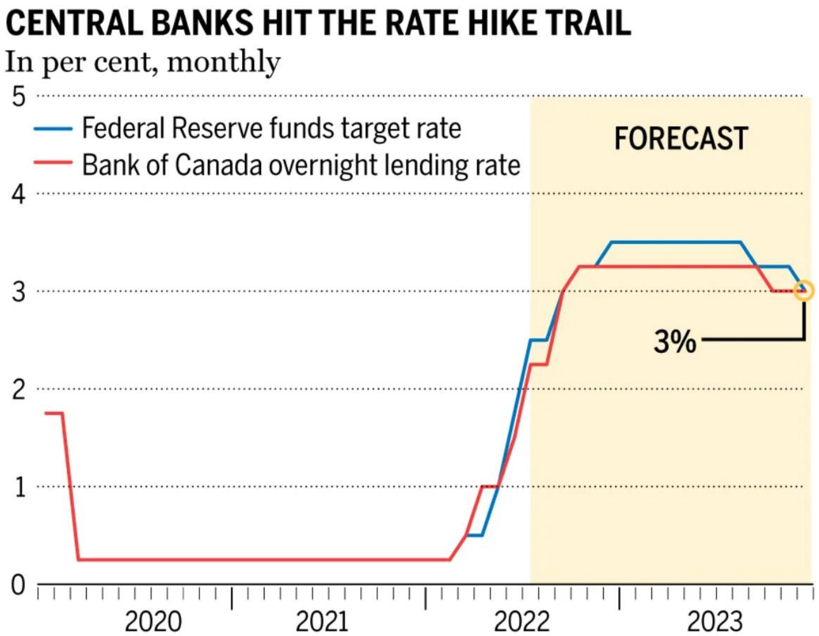


[The American Association of Individual Investors publishes a weekly investor sentiment survey to assess the "attitude" of America's individual investors. Currently the survey suggests that investors are neither greedy nor fearful but less noticeably less bearish than in past weeks. Our assumption is that recent, mixed US economic data have led some to conclude that "bad news" equals "good news" from the perspective of additional interest rate hikes, and we just aren't sure that is a credible assumption.]

Banking on a reduced pace of monetary tightening is certainly a view one can take on financial markets if that is their prerogative. Indeed, demand in some areas has moderated, thus solving a portion of the current inflation conundrum, but we do not envision the problem solving itself entirely, not in the near term anyway. Many of today's inflationary problems are structural and not necessarily the machinations of Central Banks.

Don't fight the Fed…

Picking a fight with the Fed or alternatively the Bank of Canada is one investors are likely to lose. Certainly, demand pressures have waned in recent months, but higher rates are by far the more plausible marching orders from monetary regulators in the foreseeable future. RBC Economics and Haver Analytics each predict the current tightening cycle in rates to continue well into the second half of 2022 and 2023 before moderating at approximately this time next year. A rate respite is still a way off and those who financed vehicle purchases, vacations or home renovations on credit will soon find their monthly bank account balances more vacant leading to some tough choices.



[The Bank of Canada's overnight lending rate, which is the rate that our banks temporarily lend monies to each other when they need to lend it to you, and the Fed Funds are both forecasted to rise well into 2023 (Source: RBC Economics and Haver Analytics)]

Monetary policy makers in Ottawa and Washington seem determined to tame inflation even if their actions are eventually shown to be tantamount to admitting guilt in not being able to recognize inflation as a problem years earlier. Central Bankers are experts in using economic data and statistics as veneers to shield us from the coarser realities that underpin the economy and like the bankers themselves, investors will have to walk a fine line between being forceful and vigilant. Now is not the time to be brazen with one's capital nor laissez faire about one's attitude towards investing. Thankfully, the MacNicol Investment Team does have a view on markets, and that view is cautious, and the only thing brazen around our office is the occasionally "bold" shirt/tie combination dawned by one of our staff.

Shhh…it's private…

Dr. George Athanassakos is a Professor of Finance at Western University's Ivey School of Business, and he chairs the Ben Graham program in value investing.

[University of Toronto graduates have a longstanding and highly; chivalrous, courteous & honorable "rivalry" with our counterparts at the Western University. But there should no mistaking that Western is an excellent school, with a knock-out of a Business School.]

Professor Athanassakos is well known to the MacNicol Investment Team, and it is no secret that he has referenced us in his column for the Globe and Mail in the past. In addition to teaching and research, Prof. Athanassakos has undertaken secondments in private equity. Also, no secret is the fact that our investment team appreciates the value that alternatives such as private equity can bring to investors. But rather than taking a hush-hush approach to this topic, let's consider a real-world example of just the sort of value private equity can bring to your portfolio using real estate as the canvass for the picture we will paint you.

Public real estate investment vehicles like REITs, tend to trade at a premium to their Net Asset Value or "NAV" and a helpful case in point is Prologis. Prologis (PLD:NYSE) is a leader in logistics real estate with a focus on high-barrier, high-growth markets. Prologis owned or had investments in, on a wholly owned basis or through co-investment ventures, properties and development projects expected to total approximately 984 million square feet (91 million square meters) in 19 countries. Using data provided to MAAM by real estate partners of ours in Boca Raton, FL, I calculate that, on average, since December of 1997, units of Prologis have traded at a 6.7% *premium* to their NAV on the NYSE. In addition, I also found proof of something I have long suspected, which is that REITs tend to be **more volatile** and idiosyncratic than private real estate investments. For instance, in August of 2021 Prologis units traded at a 39.3% *premium* to their NAV whereas in June of 2022, Prologis units traded at a 20.7% *discount* to their NAV, and this is quite the roller coaster ride. Pricey in general and erratic at times, REITs are the main real estate investing vehicle for the retail trading marketplace and not for sophisticated professional investors.

A second aspect of private real estate holdings that we very much like, is the ability to offer our investors specialized exposure to a <u>select</u> group of geographics or building types. Prologis is certainly a reputable REIT with a seasoned management team focusing on a class of buildings, we by-the-way happen to love, but as a landlord with nearly a billion square feet of space, Prologis has some buildings that we would love to own and others that leave us feeling a bit vacant. When you buy units of a REIT, you are buying a smorgasbord of hot (and cold) properties without any specialization or focus though I suppose the reverse argument might be true and that is big REITs offer the benefit of portfolio diversification.

[This is Luminary at 95. Luminary is a 300-unit multifamily property along the I-95 corridor in West Melbourne, Florida. This is an excellent location within the Space Coast metro area, approximately one hour from Orlando and a perfect example of a recent property in our real estate program that allows you to focus on high-conviction opportunities in strong markets like the US south while avoiding weaker areas like parts of the US mid-west.]

Leaving money on the table…

The specialized nature of private real estate also means that greater financial leverage can be deployed to amplify returns to investors. Greater financial leverage can of course catalyze losses when deployed haphazardly or in great hast, but our experience has been that when managers with specialized knowledge are incentivized to achieve long-term performance milestones, they do not often miss the mark.

[Have you ever met a private investor that enjoys leaving money on the table? Neither have we.]

Brass *taxes*…

Most of us have heard the expression "*Don't let the tax tail wag the investment dog*", but the realty is real estate investments made through limited liability companies "LLCs" or limited partnerships "LPs" can be more tax efficient than REITs for several reasons. Entities like LLCs and LPs are simple conduits for tax purposes; no tax is imposed at the entity level, and both taxable gains and losses are "passed through" to individual LLC or LP members for reporting on their individual returns. These pass-through entities not only avoid double taxation but also allow investors to obtain the full benefit of tax losses or tax incentives. Fees like carried interest represent tax deductions at the partnership level and unlike LLCs and LPs, a REITs income that is not distributed in the year it was generated is usually subject to an entity-level tax. REITs are also subject to entity-level taxes on net income from foreclosed properties, income from so called "prohibited transactions", undistributed capital gains and net operating losses of a limited partnership can help "deflect" taxation of the cash flows on a given property. We, of course, remind each of you to consult with your local tax expert for actual advice on how investing in real estate privately versus through a Public REIT might impact you but do so while also pointing out that few affluent people or sophisticated institutional investors make sizable direct investments in REITs.

If you asked Dr. George Athanassakos* to explain value investing to you, his answer might easily encompass a full hour or maybe more. This article did not require a commitment that lengthy, but we hope that it helps you appreciate the value of what we do and why its no secret that our Alternative Asset Program is now well into its 12th year.

* https://valueinvestingeducation.com/index.php/value-investing-from-theory-to-practice-a-guide-to-the-value-investing-process/

Behavioral Investing

I want to make money right now and the value of patience…

Dr. Ping Xu, currently of Shenzhen University's School of Psychology, knows a thing or two about patience. In 2020 Xu and her team set out to expand our understanding of the psychological mechanisms of patience. Specifically, Xu undertook to study the psychology behind waiting for a *larger* reward as opposed to instant gratification that came with a smaller reward.

[Intertemporal choice isn't easy to spot, doing so requires great expertise.]

Xu found that people are impatient not only when *thinking about* whether to wait or not for a larger reward, but they are even more impatient when they actually have to wait to receive that larger reward. In Xu's study, the amounts and layovers were small (cents and seconds), but even in such narrow increments Xu's experimental participants demonstrated the myopic behavior of the sooner the better even if the payoffs were tiny. Dr. Claudia González Vallejo, Xu's research partner in the study mentions that these kinds of experiments fall under an umbrella in psychology called **intertemporal choice**, which refers to studying how people balance out minor and substantial rewards when factoring in the time commitments inherent to achieve either. Xu and González Vallejo discovered that in general people are impatient, which is likely a surprise to absolutely no one. However, after the pair crunched study numbers, the following conclusions for impatient behavior were made a) time feels longer when experiencing it and b) the amount of the reward is devalued when it is delayed.No members of the MacNicol Investment Team are professionally qualified as psychologists. But I feel that as practitioners (of Asset Management) we have a ton of real-world experience understanding the psychology of investors. We know what makes you tick, the feelings you go through and the goals you have for your family and your relative wealth position. Every investor wants their capital to go up and every investor wants their capital to increase immediately. That natural intertemporal feeling that most investors have is precisely why we take time to periodically sit down with each of our investors for a review. These meetings are a lot about you, but they are also a lot about the economic and financial market environment. We feel that touching base with our investors helps set a more proper context for our choices around this like cash weightings and asset classes such as gold, which only make sense after the fact. But we also listen too: if day trading and living "in the moment" are more your style you won't have to wait long for us to tell you what we think about that. After more than 20 years, our time-tested, safe harbor approach to money management will help you make money, and if there is a delay, we will be sure to feel better about experiencing it.

The MacNicol Investment Team

Firm Wide News

We would like to congratulate Cesar Cossio, Associate Portfolio Manager, who passed his CFA Level 3 exam. This is a huge accomplishment. Congratulations!

We have been fortunate to have a summer student, Paris Skiba-Bissada, helping us digitize our files and work on some projects. Paris is going into second year at Wilfrid Laurier in Business Administration.