MacNicol & Associates Asset Management Inc.

October 2023

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 secret of getting ahead is getting started."

- Mark Twain

The Numbers:

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Index:		**2023 YTD:**
S&P/TSX:		-2.64%
NASDAQ:		22.8%
Dow Jones:		-0.3%
S&P500:		9.23%
Interest Rates:	**Canada**	**USA**
90-Day T-Bill:	5.04%	5.43%
5-Year Bond:	3.84%	4.49%
10-Year Bond:	3.73%	4.47%
30-Year Bond:	3.50%	4.60%

Economic Data:

- Canadian CPI down to 3.1% in October
- Natural gas prices make a resurgence
- BITCOIN sharply higher in the month
- Global equities higher in central bank pause
- US/China relations still miles apart
- Geopolitical risk globally sky high
- Gold bullion dips slightly in mid-November but has since come on strong
- US 10-year yield backs down to 4.5% level

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	25	22
P/B: Price-to-Book	4.1	4.5
P/S: Price-to-Sales	2.5	2.1
Yield: Dividend Yield	1.7%	1.8%

2023 Year to Date Performance, by Sector: Oct 31st, 2023

S&P/TSX Composite	-2.64%
NASDAQ	22.8%
Dow Jones Industrials	-0.3%
S&P 500	9.23%
Russel 2000 (Small Caps)	0.4%
MSCI ACWI ex. USA	1.6%
Crude Oil Spot (WTI)	2.54%
Gold Bullion ($US/Troy Ounce)	4.19%
SOX Semiconductor Index	50.3%
VIX Volatility Index	-64.2%

Source: Canaccord Genuity Capital Markets & Thomson Reuters

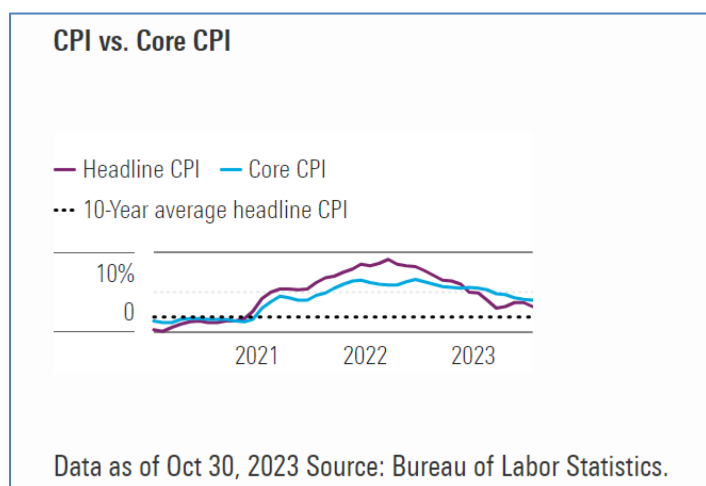
Foreign Exchange - FX

As of November 28, 2023 12:00 PM	$5,000	Cdn		
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate
CIBC	No Public Rate Posted Online			
Interactive Brokers	1.361	$3,674	$(11)	-0.3%
Laurentian Bank	No Public Rate Posted Online			
National Bank	1.3940	$3,587	$(98)	-2.7%
Raymond James	1.3579	$3,682	$(2)	-0.1%
Royal Bank	1.3841	$3,612	$(72)	-2.0%
Scotia	1.3933	$3,589	$(96)	-2.7%
TD	1.3930	$3,589	$(95)	-2.6%
Canadian Snowbird	1.3994	$3,573	$(111)	-3.1%
Spot Rate	1.3571	$3,684	$-	0.0%

The King of all astrological signs (is a Portfolio Manager) …

As those of you born between **October 23rd** and **November 21st** already know, Scorpio is the superior and greatest of all the astrological signs, and there are very good reasons why. Scorpions are intelligent, good-looking, well liked and above all very modest and humble. And that is why, when it comes to astrology, we like to say there are two (2) kinds of people in the world: those who are Scorpios, and those who would like to become Scorpios. But this article is not about Scorpio's astrological superiority, it is about investing. And this November might just be one for the record books. After 3 sequentially down months, the S&P500 has rebounded sharply, creating one of the best November gains on record. According to month-to-date data from Bloomberg, this November will only ever have been surpassed on 5 previous occasions. For answer about the implications for investors, the MacNicol Investment Team encourages you to look at the market and not the stars.

In our opinion, the main reason for the market's impressive performance was the latest batch of inflation data. American Consumer Price Index (CPI) data is one of those indicators that has the potential to ricochet across financial markets due to its ability to influence central bank policy. US CPI is widely regarded as the **main** interpretive inflation proxy that Central Banks use to gauge whether inflation is or is not within a range viewed as acceptable to achieving price stability. The Fed and other central banks each have their "preferred" measure or measurements of inflation, but few things carry the heft of the CPI. And no other source covers CPI more conclusively or more authoritatively than the Bureau of Labor Statistics. As an investor, you should never trust any other source for CPI data, unless directed by a Scorpio.



As per the chart above, from the Bureau of Labor Statistics itself, US CPI has been trending lower and recent prints were below consensus estimates. This ignited equity markets with the resulting frenzy resulting in a condition technical analysts describe as **overbought**. Andrew Adams, a technician we follow notes the market's current overbought condition in one of his typically excellent charts below. However, not as well defined in the chart are the risks that can result from rapid upwards movements in stocks. While rising stock prices are of course a good thing, they can frequently make our job tougher than easier. Sharp ascensions in stock prices create increased volatility and increase fear amount investors sitting on the sidelines in as much as they can trigger feelings of "FOMO" or Fear of Missing Out.

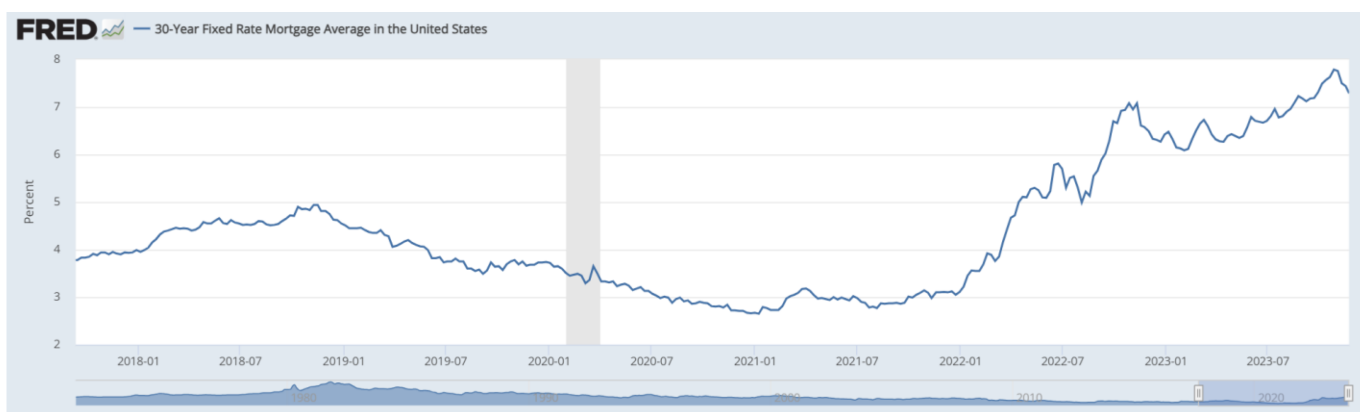
One of our greatest strengths here at MAAM is our independence and that is because it really and truly allows us to look through fear and hype. New bull markets germinate gradually and offer plenty of opportunities for high quality investments. We aren't quite sure this is that just yet, in fact we have taken very specific measures to protect against this not being that. However, we appreciate that this November is likely to resemble Scorpio's strength, leadership and all-around dominance, metaphorically in any case. What we appreciate even more is focusing on exploiting this longer-term upward trend whilst avoiding much of the attendant volatility. This is frankly difficult this month but made easier by taking a step back in time and looking at the impact of higher interest rates on historical sector performance. The most important conclusion that our team has observed is that 24 months after an increase in long-term rates, stocks have on average shown robust returns. But there exists a wide dispersion of return profiles among the various sectors. Strong performers in this kind of environment have been traditional defensive sectors such as consumer staples and healthcare, but also more cyclical areas like financials, consumer discretionary, and energy. But don't expect to see shares of the Canadian Banks added to your portfolios just yet. One sector that has struggled in this environment is technology and we expect that to be the case again this cycle. So much so that in many ways, article #2 is in some ways a primer on excessive tech investment as a harbinger of future portfolio horror.

"You've either got or you haven't got style, and if you've got it, you stand out a mile".

- Frank Sinatra

"The Chairman" probably would have been a decent company Chairman. One of Sinatra's famous quotes about style is that if you have it, you really stand out. While no member of the MacNicol Investment Team will win any fashion awards, with investing style it's about knowing which styles perform best in specific financial conditions. Value tends to detract from performance during tightening cycles but outperforms growth following a pause in rate hikes. Canadian banks, telcos, utilities, and pipelines are trading close to the bottom of their historical range but that could change if rates on 5 and 10-Year Government of Canada's decline. With beaten up Canadian Blue Chips you also get the dividend tax credit which is kind of nice. But it is really the impact of Oil and Gas stocks over the past 18 months that has made the overall S&P/TSX performance quasi acceptable, and energy has done a good job of cushioning the blow that financials have experienced. Nonetheless, one gets the impression that (one day) it will make sense to buy shares of BMO, CIBC, RBC, TD or Scotia.

Fundamentally, a lot of Canadian Blue Chips function in oligopolies which gives them pricing power and that helps in more challenging monetary environments. With telcos we have had our toe in the odd name, the odd time but our real play on the space is through privately held telMAX, which we anticipate will be acquired by one of the incumbents due to 3 factors: performance, inability to connect through overhead wiring systems and market share (each telMAX fiber optic cable going into a home is one less customer that Bell or Rogers will have). But telMAX does not yet pay a dividend. Dividend yields become less attractive relative to lower risk government bonds when rates are high, but the allure heats up in reverse (when rates are expected to fall), and we believe rates of many fixed income benchmarks have peaked (the US 30-year fixed rate mortgage is another example).

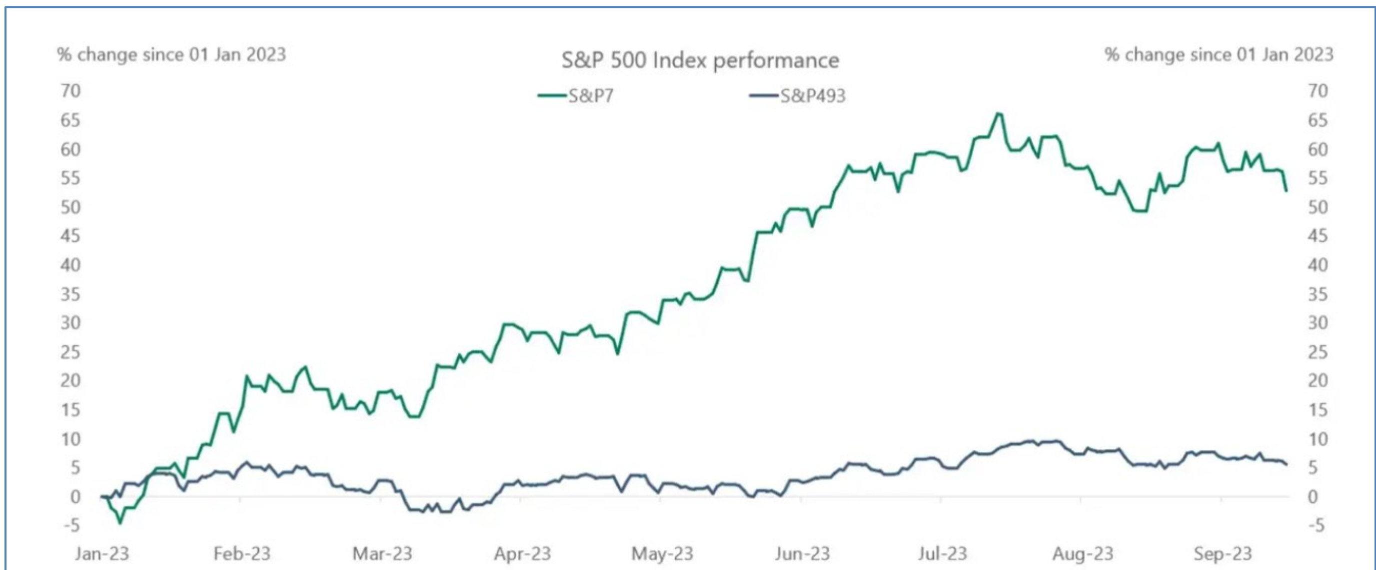


We expect that Scorpios will never change. They will still be the envy of all other astrological signs. We also expect that this November will be one of the better ones. But what we do not expect is that the job of finding investment opportunities will get any easier. There are opportunities out there but finding those opportunities will require knowledge and discipline and being a "King" won't really help much if don't look at the forest *and* the trees.

Narrow minded…

A pullback in bond yields, a rollover in CPI inflation, a Federal Reserve on hold, Taylor Swift's new boyfriend. Take your pick, but there are several reasons to be happy about stocks right now. Some legitimate, others not so much. Stocks are a broad category, so had better get to the point. But not before we point out that there are about 7,000 public companies listed on US exchanges. Shares in a further 3,000 companies trade on something called the bulletin board. And there are an additional 16,000 "companies" (shells) are mercifully only available in the over-the-counter broker market for those wanting to vaporize their savings in some of kind of dilution scam. But that's not all. About 400 foreign companies trade on US exchanges as ADRs or American Depository Receipts. And roughly 250 REITs or Real Estate Investment Trusts trade on exchanges too, and they can make you feel like a big player in the world of commercial real estate simply by clicking a mouse. We didn't even get into Canadian stocks and it's probably for the better, US stocks are having the superior year, or are they? We certainly expect the S&P500 to reach new highs, but we know that not ever stock will go up. As a matter of fact, we don't believe **most** stocks will go up. Instead, our view is that the pricey plateau presently held by just a few names is badly in need of some perspective. So many stocks out of the thousands upon thousands we reference above may be responsible for new all-time highs?

That's right seven. They are referred to as the "magnificent seven". Amazon, Apple, Google, Meta, Microsoft, Nvidia and Tesla. Were it not for shares in just these seven companies, the stock market would look a lot different. Apollo Fund Management produced a brilliant chart illustrating this below. The performance of the S&P500 *without* the benefit of the seven biggest, most heavily weighted companies is poor.



[Apollo's analysis of the "S&P493" index is really impactful because it's so easy to see.]

We call this "poor" S&P index the S&P493. But rather than ask the multifaceted question: what are the opportunities that can be found in the 493 and the risks with holding the big 7…investors are sadly asking a totally different question. *With just seven companies responsible for most gains in the stock market to date, why not simply concentrate your wealth there?* Simple, doing so would be stupid. Portfolio Managers would say "risky", but it would be just plain dumb. Call the "magnificent seven" the **malevolent seven** if you wish. Malevolent because it is frankly just evil to think you can pile into these stocks today and not have a care in the world. And malevolent because ignorance isn't bliss its ignorance and it's only curable when intrepid investors adventure deep into the composition of a stock index to discover the hidden secrets it holds. Speaking of narrow mindedness, absolutely nothing dominated the investment news more this year than Artificial Intelligence or AI.

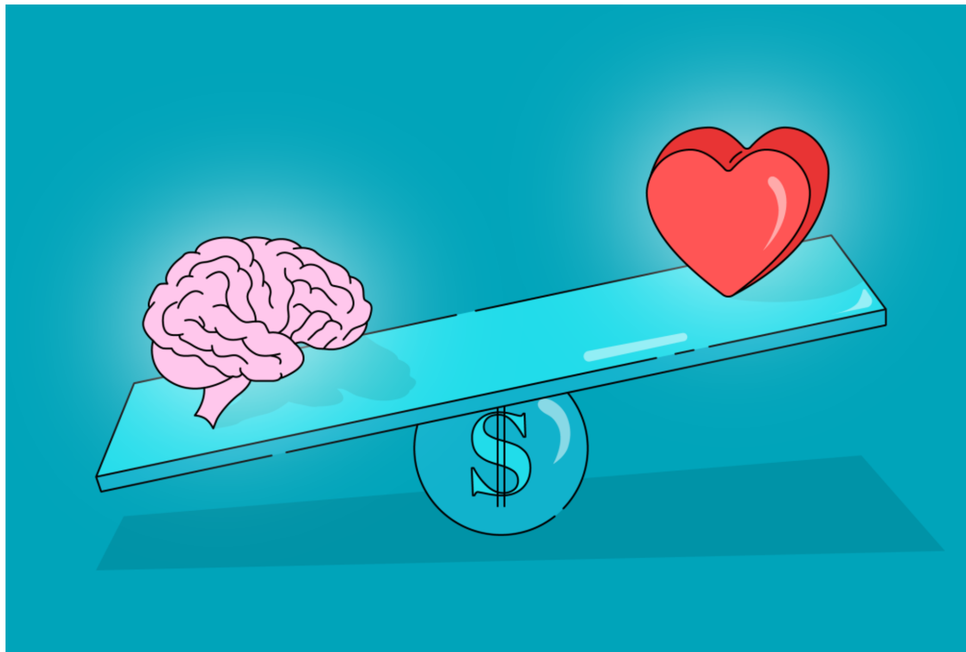
Excitement around artificial intelligence and Microsoft's gargantuan bet on ChatGPT - the program possibly writing this very commentary 😉- has made investor sentiment more polarizing than we have seen in quite some time. Some investors believe they are missing out because their portfolios achieved a rate of return that, whilst still positive, was less than what the market achieved. Worse is that other investors today seriously believe that these seven companies are a reliable, long-term wealth creator. Our various publications, webinars and commentaries have done wonders to educate many investors about what they might actually be missing. The danger of narrowing in on just seven companies is real. Do not be narrow minded. Diversification is the optimal way (we would say the only way) for an investor to achieve success in the long term. Diversity lowers risk, smooths out unpleasant volatility and makes the most of changing conditions. Being well diversified maximizes long-term returns for investors who are willing to do a little work and let go of being overly provincial. Companies leading the charge today will inevitably come down harder when conditions deteriorate.

What makes us so sure that a narrow focus in this case is a very bad thing? Well consider this: Apple trades at 29x forward earnings even though revenues rolled over slightly, Microsoft trades at 33x forward earnings but at least they had some sales growth at 13% last quarter, Tesla trades at 62x forward earnings and its sales grew too but only by 9% and Nvidia's 49x forward earnings seems hardly cheap though I will admit just this one time that is quite the company. But you see what just happened there? I allow narrow mindedness to weaken me into cutting Nvidia some slack just because it is Nvidia the super stock. It's not and none of them are. But what they are today is a huge chunk of the index, and that index itself has gotten pricey. At 25x the S&P500 is now at a level we call expensive. The bubbles on the lead into this piece were admittedly dramatic but I think necessary because the picture isn't just bubbles it's a picture of a few big bubbles that someone is obviously being drawn into. 25x also ignores the fact that many in the S&P493 do not have price-to-earnings ratios anywhere close to 25x. At anything north of 30x I think the official bubble alert sirens must go on. But forward rates of return on stocks valued at north of 25x are negative.

If your hold a self-managed portfolio someplace else that has gone up in value recently. Chances are that one or more of the seven companies mentioned here has played a roll in that. These companies are huge, expensive and in the case of Apple and Tesla stumbling, just a bit. It will no doubt be difficult for many investors to say sayonara to companies many say are the backbone of the economy so being open minded and receptive to a discussion with us is so critical.

A State of Trance: Behavioral Investing

More than any kind of CEO the CEO of a tech company is most likely to have his or her investors and business partners absolutely hooked. Whether its Steve Jobs, Bill Gates, Carly Fiorina, Ginni Rometty, Louis Westerner, Mark Zuckerberg, Jeff Bezos, Elizabeth Holmes or the King of tech Kings, Elon Musk…there's just something about how tech CEOs can get into people's heads. In my own opinion I think the angle tech CEOs play the best is the college dorm look. That look draws you down this valuation rabbit hole whereby you somehow "connect" with this vision of a visionary who started out in a basement, a garage or a college campus with absolutely nothing and then became a billionaire. Because tech CEOs usually look like crap, they tend to elicit affection from investors rather than consternation. When you see an impeccably dressed, rich looking male aged 55 or more, and then learn that he happens to be the CEO of a Bank or Insurance Company, you immediately disconnect because you think to yourself 'that's just not me'. Yet the tech CEO, by virtue of their often youthful yet disheveled appearance, takes you back to a place in your life when it was more of a "grind" and less of a smooth ride.



Tech CEOs can sometimes make you feel envious of their ability to seemingly "check out" of work situations and live in an alternate reality. Sam Bankman Fried was known to play video games such as "League of Legends" while actively involved in high level company discussion with investors and partners.

Being in a state of trance can function as a mental break or release, but it can be very bad when it builds to a level where investors become mesmerized by the preachings of CEOs who resemble Ministers giving a sermon. They say hope is not a strategy when it comes to investing and the MacNicol Investment Team certainly hopes you and your family feel the same way. If you or someone you know is riding the coattails of the latest tech scion, that's totally fine. But it is important to strike the proper balance between blind faith and constructive criticism. We can help and what's more we can do it in a non-intrusive way.

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