

September 2024

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.

"Condemnation without investigation is the height of ignorance."

— Albert Einstein —

The Numbers:

<u>Index:</u>	<u>2024 YTD:</u>	
S&P/TSX:		11.4%
NASDAQ:		18.0%
Dow Jones:		10.3%
S&P500:		18.4%
<u>Interest Rates:</u>	<u>Canada</u>	<u>USA</u>
90-Day T-Bill:	4.06%	4.98%
5-Year Bond:	2.74%	3.43%
10-Year Bond:	2.90%	3.65%
30-Year Bond:	3.06%	3.96%
<u>Economic Data:</u>		
<ul style="list-style-type: none"> • US CPI for August rose by just 0.2% • Stocks higher in August ex-Shanghai • CAD/USD higher by over 2.5% in August • Commodities mixed in August with lumber and natural gas falling • Chinese retail sales fell in the month, lagging demand continues to plague China • Canadian unemployment rate hits 7-year high in August, Bank of Canada widely expected to cut rates more forcefully now 		

<u>Valuation Measures: S&P 500 Index</u>		
<u>Valuation Measure</u>	<u>Latest</u>	<u>1-year ago</u>
P/E: Price-to-Earnings	28.6	24.3
P/B: Price-to-Book	4.9	4.7
P/S: Price-to-Sales	2.9	2.6
Yield: Dividend Yield	1.3%	1.5%
<u>2024 Calendar Year by Sector: August 31st, 2024</u>		
S&P/TSX Composite	11.4%	
NASDAQ	18.0%	
Dow Jones Industrials	10.3%	
S&P 500	18.4%	
Russel 2000 (Small Caps)	-2.6%	
MSCI ACWI ex. USA	1.60%	
Crude Oil Spot (WTI)	9.22%	
Gold Bullion (\$US/Troy Ounce)	16.2%	
SOX Semiconductor Index	11.8%	
VIX Volatility Index	-33.2%	
Source: Canaccord Genuity Capital Markets & Thomson Reuters		

Foreign Exchange - FX

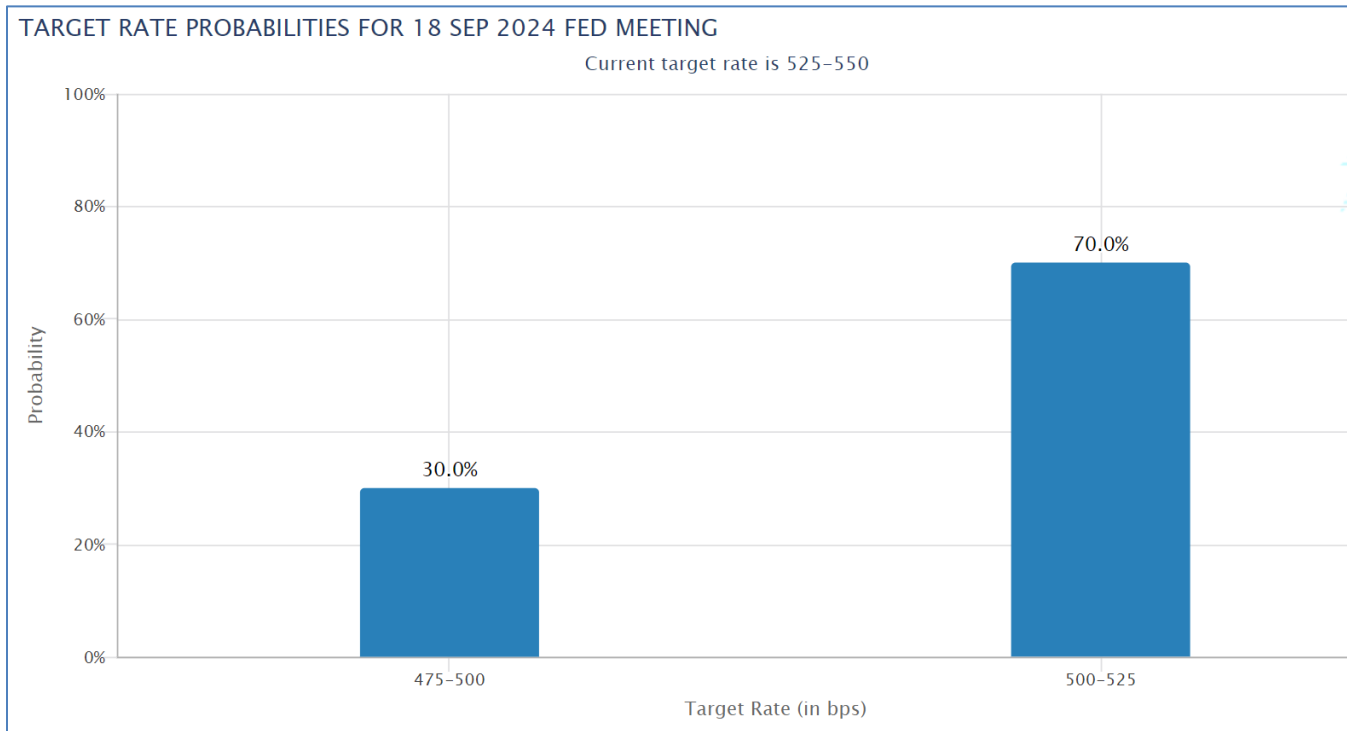
As of September 17, 2024 9:00 AM	\$5,000	Cdn			
Banks	Rate	Buy USD	Cost	% Difference from Spot Rate	
CIBC	No Public Rate Posted Online				
Interactive Brokers	1.368	\$3,655	\$(18)		-0.5%
Laurentian Bank	No Public Rate Posted Online				
National Bank	1.3935	\$3,588	\$(85)		-2.4%
Raymond James	1.3710	\$3,647	\$(26)		-0.7%
Royal Bank	1.3870	\$3,605	\$(68)		-1.9%
Scotia	1.3963	\$3,581	\$(92)		-2.6%
TD	1.3852	\$3,610	\$(64)		-1.8%
Canadian Snowbird	1.3658	\$3,661	\$(12)		-0.3%

Bilaterally loose with more to follow soon...

Canada is Switzerland's second-largest economic partner in the Americas in terms of bilateral trade and direct investment. The two countries often take a similar stance in multilateral forums, and although we tend not to think of Canada and Switzerland as economic individually, the two countries share currencies that are constituents in the US Dollar Index and therefore punch above their respective economic weights. Both the Central Bank of Canada and the Swiss National Bank have already begun monetary easing campaigns that are likely to continue into 2025. Central banks in Brazil, Chile and Peru had first move advantage around rate cuts, but Canada and Switzerland are what we would describe as more majors in global currency markets. Of course, more importantly from a global financial market context is presumed rate cuts in the United States, which are now a seemingly foregone conclusion. US Federal Reserve Chair Jerome Powell confirmed at a speech in Jackson Hole Wyoming last week that the time has indeed come to begun easing, and we suspect that the forthcoming gathering of the US Federal Open Market Committee or FOMC¹ on September 17th and 18th will be when Mr. Powell updates the world on the United States' monetary policy position with a bombshell announcement highly unlikely. The Chicago Mercantile Exchange's Fed Watch Tool pegs the probability of an interest rate cut at a stout 100%. The Fed will assuredly cut next week because of what it suggests is continued progress on the inflation front. Of course, such action itself suggests a tailwind for stocks and bonds, but two questions remain in our minds: does their exist the potential for a policy error that hinges upon the misreporting of inflation or a surprise pop in inflation down the road, and just how much have stocks and bonds priced in a rate cut of 25 or even 50 basis points (0.25% or 0.50%)? Time will tell, but the year 2024 should continue to resemble the polar opposite of 2022, a nightmare year that was frustrating for traditional balanced investors as both stocks and bonds declined right before investors' eyes. Assuming this is the first time your eyes have heard about the Fed Watch Tool, let's briefly map it out for you a bit before turning to our thoughts and perspectives later. The Chicago Mercantile Exchange's Fed Watch Tool calculates the unconditional probabilities of FOMC meeting outcomes to generate a binary probability tree. Federal funds futures, prices of which incorporate market expectations of the average daily Effective Federal Funds Rates (EFFR) during the futures contract months are published by the Federal Reserve Bank of New York each day. And the EFFR represents a transaction-volume weighted average of the previous day's rates on trades arranged by major brokers in the market for overnight unsecured loans between depository institutions.

¹ The FOMC is the Federal Open Market Committee, the body that sets the US fed funds rate.

And if the paragraph on the previous page made little sense to you, do not worry. We have pictures. The table below shows the status of the Fed Watch Tool, and it is very easy to interpret. Currently, financial markets are pricing in a 100% change of “a rate cut”, with 30% of that 100% chance now openly contemplating a 50 basis point cut.



To reiterate, the Fed Watch Tool paints a picture of a 100% chance of some type of rate cut and as an investor you must consider the implications of easing on asset mix and sector composition. Luckily, the CFA Institute has compiled data on this for investors to consider and by-and-large, the data looks pretty good. Mean returns **for stocks** are almost immediately positive following the first rate cut by The Fed and superior to bonds and cash on an inflation-adjusted basis.

But every loosening cycle is unique, so please take a moment to review the table from Schrodgers on the following page. With respect to sectors easing monetary policy is good for most stocks but tends to favor consumer stocks [both staples and discretionary] as well as tech and healthcare. Where vulnerabilities exist is in cyclicals such as energy and materials. Energy stocks have come off in recent weeks, but we feel the sell off in West Texas Intermediate must be looked at holistically with individual energy names separated into two piles: the haves and the have nots. If anything, crude oil, which is priced in US dollars, should benefit to a certain extent from a weaker US dollar environment which is to say the expectation of a plateauing economy and lower rates. Recent skittishness in crude and shares of energy producers therefore has more to do with financial market participants responding to reports of increasing global supply and a lower-than-expected demand. In Toronto, the TSX cap weighted energy index has dramatically underperformed the broader Canadian equity market since mid-August, but the energy trade has nonetheless been a “hot” place to be coming out of the pandemic. For the time being, stick to better quality names and hold your nose - energy stocks seem oversold in the short term.

Figure 1: Stocks have outperformed bonds which have outperformed cash when the Fed has started cutting rates, on average

Schroders

12-month real returns from the date of the first cut

Date of first cut	Cut to rates in each cycle, %	US stock market	Government bonds	Corporate bonds	Cash
30/09/1929 ¹	5.9	-33%	15%	16%	8%
31/12/1931 ¹	3.1	2%	30%	24%	13%
31/03/1933 ¹	1.0	82%	0%	10%	-5%
30/11/1953 ¹	1.6	46%	9%	7%	1%
31/10/1957 ¹	2.9	27%	0%	5%	0%
31/05/1960 ¹	2.7	22%	8%	7%	1%
30/11/1966	2.0	17%	-10%	-7%	2%
28/02/1970 ¹	5.3	7%	4%	8%	1%
30/09/1971	2.3	12%	2%	6%	1%
30/09/1973 ¹	1.8	-45%	-16%	-21%	-3%
31/07/1974 ¹	8.3	7%	3%	7%	-3%
30/04/1980 ¹	8.6	19%	-17%	-18%	1%
31/01/1981 ¹	4.4	-10%	-4%	-9%	6%
31/07/1981 ¹	6.7	-19%	14%	11%	6%
30/04/1982 ¹	6.4	43%	30%	39%	5%
31/08/1984	5.8	14%	25%	26%	5%
31/05/1989	6.9	12%	3%	3%	4%
30/06/1995	0.8	23%	0%	2%	3%
30/09/1998	0.9	25%	-11%	-8%	2%
31/12/2000 ¹	5.4	-13%	2%	9%	2%
31/07/2007 ¹	5.2	-16%	3%	-5%	-3%
31/07/2019 ¹	2.4	11%	24%	21%	0%
Average		11%	5%	6%	2%
Average: no-recession		17%	2%	4%	3%
Average: recession		8%	7%	7%	2%

[Schroders notes research from the CFA Institute and Ned Davis that shows stocks as the superior option in a rate cutting environment. Not all sectors however are created equal and given that rate cuts often occur in response to less vigorous economic activity, energy stocks should be selected with a focus on quality rather than speculation.]

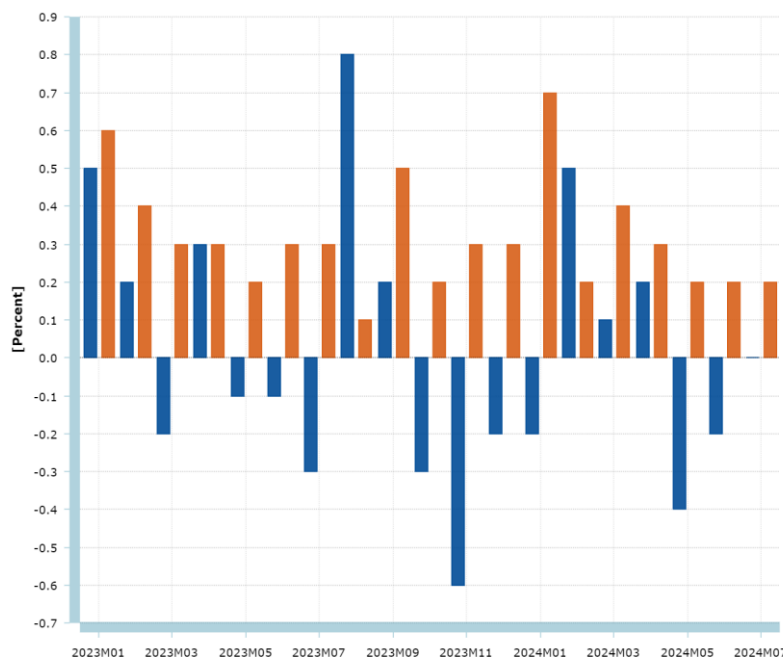
Rate cuts are also helpful to shares in utilities and certain financial names, and indeed those sectors have performed well-to-reasonably-well respectively in 2024. We are not completely convinced that the time is nigh to begin loading up on banks, but it is definitely the time to begin thinking about thinking about loading up on banks. Note from the front page of this publication, the term structure of interest rates in both Canada and the United States is if nothing more still quite flat, and problematic for less diversified banking names who continue to borrow short and lend long:

<u>Interest Rates:</u>	<u>Canada</u>	<u>USA</u>
90-Day T-Bill:	4.06%	4.98%
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But what about the risk of a policy error or an unanticipated rise in inflation? Those are really hard questions to answer. But we shall try our best...

Trade and personal consumption?

The merchandise trade deficit is a measure of how much extra stuff the United States makes over-and-above its own needs. A deficit is a negative number and the negative \$75 billion US merchandise trade deficit recently reported means that US quarterly GDP is likely to be adjusted down by up to 1%. The United States quite simply doesn't produce enough for itself, and the shortfall must be made up for by importing stuff from trading partners and the situation was only worse during COVID when travel restrictions prevented the United States from importing the stuff it needed that frenzied buying [imports] transpired when restrictions were lifted. The value of goods and services exports decreased 0.7%, while imports fell 0.3%. The figures aren't adjusted for inflation, and it is probably for the better because when you consider the performance of the US Dollar Index has been so bad of late, you wonder what the figures would look like adjusted for inflation. The point being that the underlying US economy is a hollowed-out shell of what it was 30 or 40 years ago, when Americans went to work and made things. Today's "strength" in the US economy is defined more so by high flying tech stocks and AI than by people actually creating value. Capital raised from investors isn't truly economic output produced by a healthy manufacturing base. And a second problem is that one of the Fed's favored inflation metrics the Personal Consumption Expenditures is viewed as a potentially slippery gauge of inflation compared to the Consumer Price Index or CPI.



[The Personal Consumption Expenditures index, with the blue bars representing goods and the orange bars representing services, has definitely slowed. But is it truly the best way to measure inflation? Source: US Bureau of Economic Analysis.]

At issue is that personal consumption data may reflect measurement errors that occur during collection and in source data provided to the Bureau of Economic Analysis. The personal consumption expenditures number may *also* reflect classification errors in the personal sector and other areas. Personal consumption figures are also thought to *underrepresent* inflation since certain inputs into the measurement include payments by 3rd parties such as healthcare providers. Prior year personal consumption data are also subject to revision each year. That can result in different measurements over extended periods, which some economists feel reflects the inability to value personal consumption expenditures accurately.

On the other hand, the consumer price index or CPI includes only out-of-pocket spending made directly by consumers. Betting that the Fed cuts rates next week is a safe bet. Betting on which areas of financial markets will benefit from easing is more nuanced. And as far as betting on policy errors or errors in which economic indicators to use when, well, that is ultimately up to the markets to decide. As we have learned from our 23 years of experience, the markets are anything but bilateral.

A good, quick parking spot...

We touched upon the US 10-year note in our first article but thought we would dive into the bond market bellwether with a combination of technical analysis and a view towards asset allocation. Andrew Adams, a noted technical analyst we follow closely with Saut Strategy, has been unequivocal when it comes to the US 10-year bond: it is too early to conclude that a new bull market in bonds is upon us. With that said bonds have rallied here mainly on expectations that inflation has been contained by central banks, most notably The Fed, and that rate cuts are forthcoming. Technically speaking, the challenging thing for fixed income investors to scrutinize now is whether the micro rally in bonds has placed the group in a position of vulnerability. We quoted work from the CFA Institute that showed rate cuts to be a general tailwind for financial markets, but with stocks receiving the Lion's share of the upside lift. So, where do we think bonds will go from here? In a nutshell, we don't know. But as far as how you should think about bonds...we feel we have some good feedback for you on that matter.



[Andrew Adams is a technical analyst with Saut Strategy and his work on the US 10-year like the rest of his work is typically excellent. That said, we respectfully disagree with Adams about his question as to whether what fixed income investors have experienced thus far is the beginning of a new bull market in bonds or simply another big bond bust from a higher precipice.]

As the Federal Reserve gears up for its first interest rate cut, we believe investors can best position their portfolios for easing rates by thinking about fixed income tactically and temporarily. To use a real estate analogy, stocks are the building, and bonds are the parking spot. So be tactical and don't fall in love with bonds for too long. The bond rally will likely come to an end soon. We feel investors are best advised to use fixed income securities as a temporary hiding spot to stash capital until they find more common shares of attractive priced stocks to buy. The MacNicol team has at times used bonds in between investing operations in portfolios but with a good rally now in the rear-view mirror.



While we expect the yield on the 10-year [above chart] to trend lower in 2024, the benchmark note is likely to be more volatile in 2025. Longer-duration fixed income securities could represent a good “parking spot” and investors should opt for treasury bonds as opposed to corporates as we could see an uptick in downgrades during the final quarter of 2024. There is nothing wrong with a little fixed income allocation in your portfolio. But remember, resurgent inflation and rising yields can wreak havoc on an area of portfolios often viewed as “safe”. If you are holding bonds in large excess, consider our complimentary review. Not all bonds are the same, and neither are investors.

Behavioral Investing: when ignorance *isn't* bliss...



In, *Ignorance by Choice: A Meta-Analytic Review of the Underlying Motives of Willful Ignorance and Its Consequences*, psychologists; Linh Vu, Ivan Soraperra, Margarita Leib, Joël van der Weele, and Shaul Shalvi shared with the American Psychological Association their study into choice and ignorance.

The team found that when given the choice to learn how their actions will affect someone else, 40% of people will choose ignorance, often to have an excuse to act selfishly. Vu et al also found that when given an option, 40% of

people chose not to learn the consequences of their actions. That willful ignorance was correlated with less altruism: people were 15.6 percentage points more likely to be generous to someone else when they were told the consequences of their choice compared with when they were allowed to remain ignorant. One hunch about why people often opt to “turn the blinders on” is [willful ignorance] is that some people behave altruistically because they want to maintain a positive self-image of being an altruistic person. In those cases, willful ignorance can allow them to maintain that self-image without having to act in an altruistic way.



In your own personal social circles, willful ignorance can come with consequences of its own whether you choose to accept or acknowledge them or not. However, in financial markets, ignorance hits you where it hurts most: your pocketbook. Earlier in this publication, we tried our best to take a horrible economic indicator [Merchandise Trade Deficit] and disassemble the media’s positive spin on what is a very blurred barometer of US economic health. But we also try to draw your attention to a data point you might otherwise willfully ignore.

There are two things the MacNicol Investment Team never ignores: our clients and our duty to thoroughly research financial markets and the economy. That approach is how we have been doing business for 23 years now, and it is why we have always offered investors a safe harbor for their hard earned money.

The MacNicol & Associates Asset Management Investment Team

Firm Wide News:

David MacNicol is excited to be a presenter at the 4th European Value Investing Conference in Athens, Greece on October 17, 2024.

The Ben Graham Centre for Value Investing (Europe), in collaboration with the Greek Centre for Value Investing, is hosting this Conference. The mission of the Conference is to promote the tenets of value investing as pioneered by Benjamin Graham, to expose Conference participants to the various value investing methods used by practitioners and to encourage and support academic research and study in the area of value investing.

Happy Birthday!!!

MacNicol & Associates Asset Management turned 23 years old on September 17th, 2024.