TD Wealth

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Quarterly Portfolio Management Update

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Commentary

It is presently 7:40 pm on Monday, October 28th. I expected to have this letter written two weeks ago. *Clearly the muse did not arrive on time.*

My mind is usually racing - exploring new ideas, grabbing a hold of various themes and cleanly inserting them into my regularly evolving worldview. While it's a more subjective and qualitative process than Thomas Bayes[1] would have promoted, it's one that, up until now, has served me well. I have, however, recently been struggling to gather my thoughts into a tidy pile - one that resembles the usual order that surrounds me. It has been an impossible task.

Marie Kondo[2] comes to mind. Is it odd that this phenomenon recently became popular? Be honest… *Have you grabbed a sweater this year and asked yourself if it sparked joy?* At home we have been striving for a simpler life. That is, less activities on our weekly calendar or less clutter in the garage. I think it's a very interesting trend. While fad diets come and go, it is not usual for everybody to become obsessed with organizing their closet. *Can you think of anything less sexy?*

Consider Newton's third law of motion: "for every action, there is an equal and opposite reaction". If we concede that trying to figure out the best way to fold a sweater or to organize our underwear drawer is an attempt to regain control, to pursue order, then what is its equal and opposite reaction? Perhaps, *just perhaps*, we are all aware of the chaos that surrounds us outside of the home. The political landscape, the social mood, and the economic realities are

[1] mathematician from the 1700s focused on probability
[2] *The Life-Changing Magic of Tidying Up: The Japanese Art of Decluttering and Organizingg*

dynamic and volatile. Perhaps, like me, we are all struggling to organize our thoughts about them into a tidy pile.

I believe I can skip over the political and social shenanigans that have arrested the ethos of 2019 *(and likely 2020, 2021, 2022?)* We just witnessed a completely uninspiring election campaign. No bold ideas were put forward to the Canadian people; some of the biggest social issues of the day were tested, and skated past; and, clearly the divide between provinces and urban versus rural voters is increasing. Yes, I think it's safe to say that those piles are as messy as ever.

Let's then look at the economy.

In Q1, I outlined some of the headwinds that economies were facing globally. Specifically, I noted that debt levels were extremely high and rising; that interest rates were low and likely to cause problems regardless of their next directional move; that trade wars were intensifying; and, that anti-trust and privacy legislation were possible impediments to equity values moving forward. That was in January. Today, we find ourselves worrying about the same variables, though mostly in a heightened state.

Debt levels have not receded.

Interest rates have fallen off a cliff. Notably, there is over $17 trillion of negative-yielding debt in the global economy. *Picture this. You walk into the bank and ask for a loan. The banker not only approves the loan, but he also agrees to PAY YOU interest every month.* This is what negative-yielding debt is. Confused? You should be. *Even Marie Kondo couldn't organize that mess!*

Trade wars are front and centre as we close out 2019. The US and China seem to be at an impassible stalemate and each country has implemented tariffs to try and assert its dominance.

Last week, Mark Zuckerberg[3] testified in front of the US Congress, during which a lot of the questions focused on Facebook's effort, or lack thereof, to protect its users' privacy.

A recurring theme in the Democratic Party's candidate debates is anti-trust legislation. The current front-runner, Elizabeth Warren, advocates breaking up the largest, most omnipresent, technology companies.

If investors consider these issues in concert with climate activism, Brexit (*or Bremain?*), the protests in Hong Kong, a clear softening in almost every traditional economic indicator, the

[3] Co-Founder and CEO, Facebook

emerging suspicion that private equity valuations are truly indefensible, and that unicorns are actually mythical creatures; it is reasonable to conclude that economies are strained, asset values are stretched, and a pullback in equity markets is more likely than another push higher.

Though, *there are also reasons to believe in fairy tales and happy endings.*

In Q2, I likened global central banks to over-protective parents; *you know, the kind that only let their children trick-or-treat at the mall*. Throughout 2019, this narrative has remained intact.

While we expected interest rates to rise in 2019, their ascent stalled out quickly as bankers became jittery about market volatility and possibly other systemic risks within the fray. The US Federal Reserve began lowering its target rate in July - its first decrease since 2008. They have continued cutting since.

While quantitative easing (QE) ended in 2018, and central banks intended to reverse course, this plan was also abandoned. In fact, as of this month, the Federal Reserve has reintroduced a new version of monetary stimulus, much like its former QE programs.

As noted in my Q3 commentary, these efforts have proven successful for the past 10 years in buoying equity markets and even propelling them higher. Central banks are consistently showing they are willing to do *whatever it takes* to keep this equity bull running - even if it means using copious amounts (*lethal amounts?*) of performance enhancing drugs.

We must pause, though. As posited in my other notes this year: how comfortable should investors be with this set up? *To me, it is akin to inviting Marie Kondo over to tidy up and subsequently helping her hide all of your small items under the bed and all of your junk in a storage locker.* Sure, your guests will think everything is clean and tidy, but deep down you know there are still two messes that will eventually need to be sorted out and sent to the dump. *To me, the need to print more money and to regularly cut rates does not spark joy.*

There is also an upcoming federal election in the US. I don't think anyone needs to be convinced that President Trump will employ a herculean effort in his reelection campaign. The economy matters to voters. President Trump knows this. It would be unwise to brush off his ability to mitigate severe storms with respect to financial markets. After all, he has, up until now, been very resilient.

Performance and Positioning

Thus far, 2019 has proven to be very fruitful for investors. Equity markets have soared in 2019 with the S&P 500 up 20.55% and the S&P TSX up 19.11%. Broadly, our clients are currently up 7 to 8%, after fees.

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One word of caution: Do not lose sight of the forest for the trees. January 1st is an arbitrary date from which to measure performance. This is always true, but more relevant in years such as 2019, when almost all the gains investors have earned can be attributed to their losses at the tail end of 2018. Over the past 12 months, the performance of equity markets paints a very different picture than the year-to-date returns noted above. For example, since October 1, 2018 the S&P 500 is only up 4.25%. Broadly, our clients have outperformed that index by approximately 1%, after fees, over this time.[4]

By now, you will be aware of how defensive we have been with respect to our asset allocation decisions over the past year. We have regularly noted that we feel like the risks present in the market are higher than investors should be willing to assume for the commensurate expected returns. We have, in our mind, managed our emotional tendency towards *greed* very well. As we reflect on 2019, and think about what may happen next, we are also managing our emotional tendency towards *envy*. We know that markets can be irrational for a long time and that it is easy to get caught up on what *we could have earned* had we invested more heavily in risky assets. We need to cauterize these feelings as they surface. We remain committed to preserving our clients' capital and waiting for more attractive prices to deploy additional money into stocks and bonds.

On a final note, Bill, Louise, and I would all like to thank you for your continued trust in our advice. We truly love our jobs and are grateful that we get to work with so many wonderful families and friends. From our Bayswater family to your own, we wish you a wonderful holiday season and good fortune and health in 2020.

From the Bayswater Group,

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[4] Sources: TD Securities Inc., Bloomberg Finance L.P. Total Return. As of September 30, 2019.

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