TD Wealth

Private Investment Advice

The Charter Group Monthly Letter

September 2017

Mark Jasayko, MBA, CFA
Portfolio Manager & Investment Advisor
TD Wealth Private Investment Advice
The Charter Group, Langley, BC

Economic & Market Update

Discoveries Revealed During Disruptions

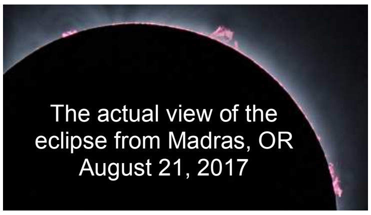
Lights out on Mt. Jefferson

MADRAS, Ore. (August 21, 2017) -- Thirty miles to the west, Mt. Jefferson, the second highest peak in Oregon at 10,497 feet, was lit up by the mid-morning sun as light reflected off of its glacial cap. Then, in an instant, the gleaming peak was transformed into a charcoal grey silhouette. Travelling eastward at 2,260 mph, the menacing shadow would arrive in less than a minute.

In fields ranging from astrophysics to finance, rare and disruptive events often provide opportunities to gain new insights.

TD Wealth

I began to glance skyward, but the glare of the sun was still too bright to observe directly. Looking back at the shadows on the ground it quickly became hard to discern them from the rest of the darkening surface. Then, a chorus of screams: "It's starting!"


The actual view of the eclipse from Madras, OR August 21, 2017

In every other case, celestial objects that can be seen with the naked eye either emit or reflect light. But, in this case, for a little over two minutes, an inky black ball was suspended in the sky. Outlining the black ball was a thin ruby red line created by massive ejections of plasma erupting from the sun. Slightly further out was the silvery white corona, a part of the sun's atmosphere that burns much hotter than the actual surface. Further out from the main event, the winter constellations of Leo and Orion began to twinkle in the summer sky. Then, a bright flash of white light and, within a couple of minutes, the mother of all traffic jams.

In more normal circumstances, astronomers are able to attach something called a coronagraph to a telescope to block out the glare of the sun in order to observe the sun's atmosphere or other objects situated close by. However, using the moon as a coronagraph dramatically improves the observations. It was this method that led to the discovery of helium during an eclipse in India in 1868, and which proved Einstein's general theory of relativity during an eclipse off the west coast of Africa in 1919.

Rare total solar eclipses over populated and convenient locations provide scientists with the opportunity to test their theories.

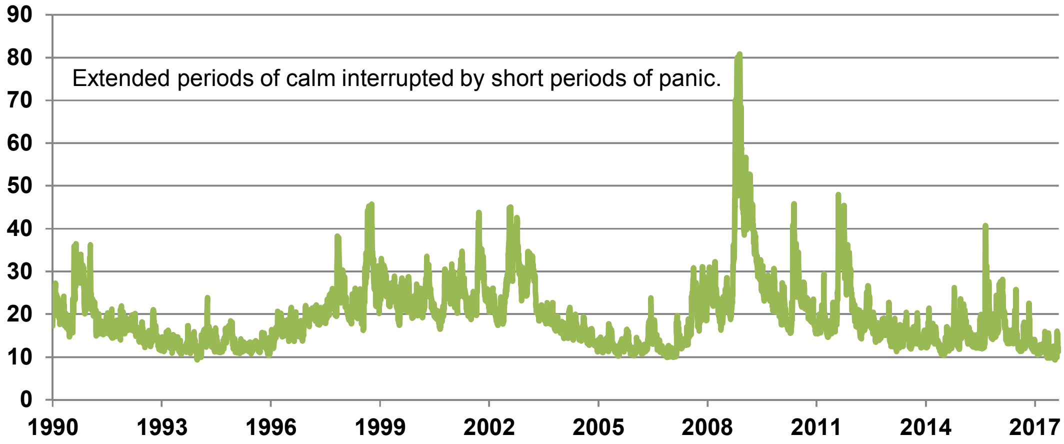
The problem with this method is that total solar eclipses are relatively rare and, when they do occur, often it is over ocean or terrain that is remote or inaccessible. In these cases, it becomes logistically difficult or impossible to transport large pieces of optical equipment. This helps to explain why after all the years of researchers chasing eclipses there still is scientific merit in using the occasion to make observations.

Since the path of totality of this year's eclipse was the first to sweep over populated areas of North America since 1979, it was relatively easy for research institutions like NASA to set up large portable telescopes and to send up a fleet of chase jets in an attempt to piece together a number of puzzles. For example, there are still mysteries as to why the sun's corona is much hotter than its surface, and how the sun's magnetic field impacts our weather.

Analogous to the rarity of total solar eclipses are the short spikes of extreme volatility in the financial markets (**Charts 1, 2 & 3**). Although these financial events have the potential to strike fear in investors just as eclipses would cause the ancients to panic, we are able to observe the correlations between different asset classes and the actual impact on a portfolio. In normal times, even though portfolio managers who have access to risk management tools are able to simulate portfolio performance during periods of high volatility, there is nothing like to real event to reveal the strengths and weaknesses of a particular asset allocation strategy.

Rare periods of financial disruption, although not pleasing, provide portfolio managers with an opportunity to observe the true defensiveness of their strategies.

Chart 1:
CBOE S&P 500 Volatility Index

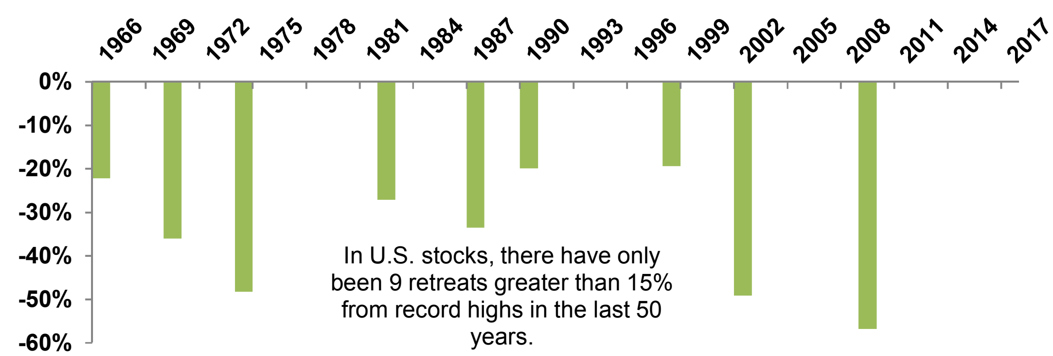


Source: Bloomberg Finance L.P. and the Chicago Board Options Exchange as of 9/1/2017

The insights gained can be put to use in designing better portfolios for the future.

The Bloomberg terminal on my desk allows us to do the simulations. We can distill the overall global financial markets into three dozen variables. I am then able to change the variables (increasing interest rates, decreasing oil prices, decreasing economic growth etc.) to see what the portfolio impact might be.

Chart 2:
S&P 500 Index: Market Bottom from Previous Record High

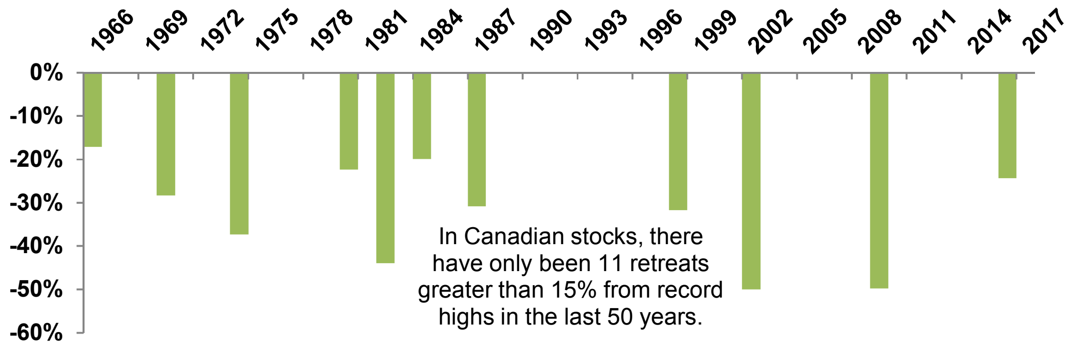


Source: Bloomberg Finance L.P. as of 9/1/2017

This at least provides a reference point with which to estimate what the portfolio risk might be. However, there are two shortcomings involved with this process. The first is that I don't know exactly what the next financial crisis will look like. Therefore, it is not really possible to pre-establish all the conditions accurately. Secondly, the simulation utilizes historical correlations between various asset classes. But history doesn't exactly portend the future and how those correlations may have changed because of new factors that impact them. These factors have recently included the faster dissemination of news and new trading technology which speeds up the rate at which market transactions can be completed.

Chart 3:

S&P/TSX Composite Index: Market Bottom from Previous Record High



Source: Bloomberg Finance L.P. as of 9/1/2017

Also, a period of extreme volatility can *by itself* alter the correlations within the portfolio. In some of the more recent episodes of global financial turmoil, the correlations between asset classes that have historically moved in opposite directions began moving together for a short period of time which significantly added to portfolio risk.

The ability to continually stress-test a portfolio under simulated conditions is still limited primarily to portfolio managers who have access to the resources needed to conduct on-going risk assessments. Even though we will have to wait until the next episode of volatility to see how our model portfolios will truly react during the stress, at least we are always working on estimating the reaction. Without the use of a Bloomberg terminal or some other robust risk management software, an investor won't have much more than a vague notion of how a portfolio will hold up. In that case, they might share similar emotions to those in the Middle Ages who would equate "eclipse" with "apocalypse."

Portfolios that have been stress-tested can provide a measure of added comfort when markets become volatile.

TD Wealth

Model Portfolio Update[1]

The Charter Group Balanced Portfolio
(A Pension-Style Portfolio)

	Target Allocation %	Change
Equities:		
Canadian Equities	15.0	None
U.S. Equities	35.7	None
International Equities	9.3	None
Fixed Income:		
Canadian Bonds	25.5	None
U.S. Bonds	2.5	None
Alternative Investments:		
Gold	7.5	None
Commodities & Agriculture	2.5	None
Cash	2	None

No changes were made to The Charter Group Balanced Portfolio during August.

No changes were made to the asset allocation or the holdings during August.

The "contributor of the month" to the Portfolio was gold bullion which we currently hold at a target weight of 7.5%. Over August, the price of gold in U.S. dollars rose from $1,268 to $1,322.[2] There were three factors that I believe were behind the increase. First is the general decline in the U.S. dollar versus the other major international currencies on the concern that the American economy is slowing down and that this might postpone interest rate increases. Second is the uncertainty regarding North Korea. Third is the potential inflationary effect of President Trump's desired spending objectives (primarily the wall and infrastructure projects while simultaneously pursuing sizable tax cuts). Currency traders may be overreacting on the first two factors but may be prescient while being early on the third factor.

Gold was the standout of the month because of concerns regarding the U.S. economy, U.S. budget politics, and North Korea.

[1] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 5/5/2017. The asset allocations of individual clients invested in this Portfolio will differ because of the relative performance of the asset classes since the last rebalancing and because of differences in the timing of deposits and withdrawals. The Balanced Model Portfolio is part of a sequence of five portfolios ranging from conservative to aggressive: Conservative, Balanced Income, Balanced, Balanced Growth, and Growth.

[2] Source: Bloomberg Finance L.P. as of 9/1/2017.

August also saw a levelling out of some recent trends. The Canadian dollar was mostly unchanged for the month versus the U.S. dollar after gaining over 10% from an interim low in early May. Because of the U.S. and international diversification in the Portfolio, a strengthening Canadian dollar has been a headwind since the spring. However, as we approach the autumn, currency traders bullish on the Canadian dollar will have to wrestle with proposed increases in small business taxation in Canada versus proposed tax cuts in the U.S., and the real estate-related risk to the Canadian economy in light of potentially higher Canadian interest rates.

The Canadian dollar might be hitting more resistance in its rise against the U.S. dollar.

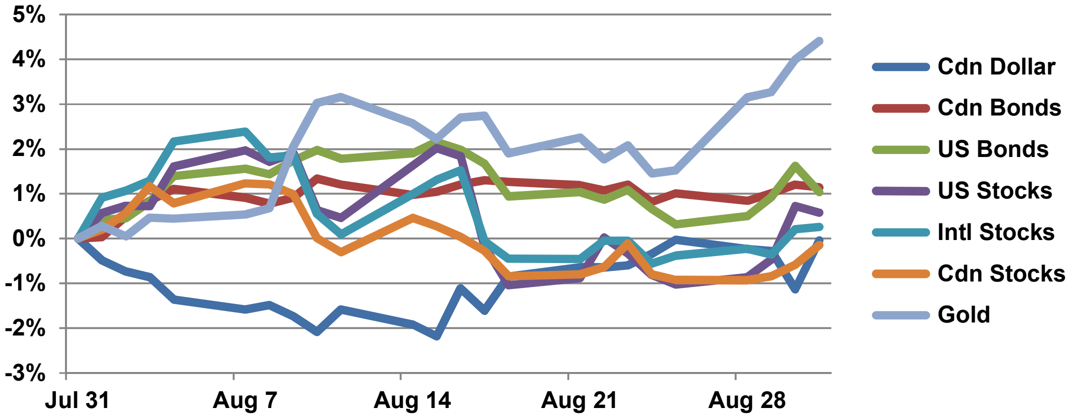
Looking forward, are we going to see a "Disruption" like those discussed in the first section of this *Monthly Letter* that will test the Balanced Portfolio's defenses? Historically, September is the worst month for stocks. However, tumultuous Septembers are often characterized by a catalyst factor that sends investors running for the hills. At the current time, the mood in the markets appears to be one where prices are slowly climbing a wall of worry without any trigger. A deterioration of the situation in North Korea or a U.S. Navy encounter with China in the South China Sea could quickly change things, but at this point they appear to be low probability events.

Stock market investors appear to be climbing a wall of worry. However, they have yet to find a trigger event that might change their behavior.

Below is the August 2017 performance of the asset classes that we have used in the construction of The Charter Group Balanced Portfolio (**Chart 4**).[3]

Chart 4:

August 2017 Performance of the Asset Classes (in Canadian dollars)



Source: Bloomberg Finance L.P. as of 9/1/2017

[3] Source: Bloomberg Finance L.P. – The Canadian dollar rate is the CAD/USD cross rate which is the amount of Canadian dollars per one U.S. dollar; Canadian bonds are represented by the iShares Canadian Universe Bond Index (XBB); U.S. bonds are represented by the iShares Core U.S. Aggregate Bond Index (AGG); U.S. stocks are represented by the iShares Core S&P 500 Index (IVV); International stocks are represented by the iShares MSCI EAFE Index (EFA); Canadian stocks are represented by the iShares S&P/TSX 60 Index (XIU); Gold is represented by the iShares Gold Trust (IAU).

Top Investment Issues[4]

Issue	Importance	Potential Impact
1. China's Economic Growth	Significant	Negative
2. Canadian Dollar Decline	Moderate	Positive
3. Long-term U.S. Interest Rates	Moderate	Negative
4. U.S. Fiscal Spending Stimulus	Moderate	Positive
5. East Asian Geopolitics	Moderate	Negative
6. Canada's Economic Growth (Oil)	Moderate	Negative
7. Short-term U.S. Interest Rates	Medium	Negative
8. Massive Stimulus in China	Medium	Positive
9. Japan's Money Printing	Light	Positive
10. Europe's Money Printing	Light	Positive

[4] This is a list of the issues that we currently deem to be the ten most important with respect to the potential impact on our model portfolios over the next 12 months. This is only a ranking of importance and potential impact and *not* an explicit forecast. The list is to illustrate where our attention is focused at the present time. If you would like an in-depth discussion as to the potential magnitude and direction of the issues potentially affecting the model portfolios, we encourage you to email mark.jasayko@td.com and set up a time to talk face-to-face or by phone.

TD Wealth

The Charter Group

Mark Jasayko, MBA, CFA | Portfolio Manager & Investment Advisor
Mike Elliott, BA, CIM, FCSI ® | Portfolio Manager & Investment Advisor
Laura O'Connell, CFP ®, FMA | Associate Investment Advisor

TD Wealth Private Investment Advice

604 513 6218
8621 201 Street, Suite 500
Langley, British Columbia V2Y 0G9

The Charter Group at TD Wealth Private Investment Advice is a wealth management team that specializes in discretionary investment management. For an annual fee, we manage model portfolios for private clients and institutions. All investment and asset allocation decisions for our model portfolios are made in our Langley, B.C. office. We do not outsource any of the decision-making for our model portfolios – there are no outside actively-managed products or funds. We strive to bring the best practices and the calibre of investment management normally seen in global financial centres directly to the Fraser Valley and are accountable for the results.

Accountability is further enhanced by the fact that we commit our own investable wealth to the same model portfolios in which our clients are invested.

The information contained herein is current as of September 1, 2017.

The information contained herein has been provided by Mark Jasayko, Portfolio Manager and Investment Advisor and is for information purposes only. The information has been drawn from sources believed to be reliable. Graphs and charts are used for illustrative purposes only and do not reflect future values or future performance of any investment. The information does not provide financial, legal, tax or investment advice. Particular investment, tax, or trading strategies should be evaluated relative to each individual's objectives and risk tolerance.

Certain statements in this document may contain forward-looking statements ("FLS") that are predictive in nature and may include words such as "expects", "anticipates", "intends", "believes", "estimates" and similar forward-looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest and foreign exchange rates, equity and capital markets, the general business environment, assuming no changes to tax or other laws or government regulation or catastrophic events. Expectations and projections about future events are inherently subject to risks and uncertainties, which may be unforeseeable. Such expectations and projections may be incorrect in the future. FLS are not guarantees of future performance. Actual events could differ materially from those expressed or implied in any FLS. A number of important factors including those factors set out above can contribute to these digressions. You should avoid placing any reliance on FLS.

Index returns are shown for comparative purposes only. Indices are unmanaged and their returns do not include any sales charges or fees as such costs would lower performance. It is not possible to invest directly in an index.

The Charter Group consists of Mark Jasayko, Portfolio Manager, Investment Advisor, Mike Elliott, Portfolio Manager, Investment Advisor, and Laura O'Connell, Associate Investment Advisor. The Charter Group is part of TD Wealth Private Investment Advice, a division of TD Waterhouse Canada Inc. TD Waterhouse Canada Inc. is a subsidiary of The Toronto-Dominion Bank. TD Waterhouse Canada Inc. – Member of the Canadian Investor Protection Fund.