TD Wealth

The Charter Group Monthly Letter

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

Economic & Market Update

"Breaking News"

A couple of weeks ago I arrived home and turned on the TV to watch some cable news. There was a “Breaking News” banner displayed along the bottom of the screen along with a headline about one of President Donald Trump’s sons interacting with Russians. It seemed to me that there was a similar story with a “Breaking News” banner a few months before with only a few minor differences. In fact, *that* banner has appeared on more days than not, and it almost always has something to do with the U.S. President, included tweets that span a whole range of banal subjects, or leaked developments from the on-going special counsel investigation into foreign interference in U.S. elections.

General news media focuses on the chaotic U.S. political drama. Financial news media focuses on the big picture.

This creates two very different simultaneous conclusions.

There may, or may not, be a constitutional crisis in the U.S. It depends on which particular cable news channel that I watch. Various members of Congress are calling for impeachment for perceived constitutional violations. There is even a billionaire hedge fund manager named Tom Steyer who is financing his own ads imploring citizens to rise up and demand impeachment. The President's personal behaviour and outbursts, combined with this fierce opposition, appear to have eroded his job approval (**Chart 1**).

President Trump's job approval numbers have fallen while investment markets have gone in the opposite direction.

Chart 1:

Trump Job Approval Poll - Real Clear Politics

Source: Bloomberg Finance L.P. as of 1/5/2018

However, it has been almost a year now, and the self-contradicting, debt-loving, big-spending real-estate developer/showman is still in office.

Removing a President is a long-shot without smoking-gun evidence.

It is reasonable to expect at least three more years of President Trump at the helm.

Impeachment is only a Congressional "indictment" voted on by the House of Representatives.[1] Congressional "conviction" and removal from office is something on which the Senate votes *after* impeachment. And, with a two-thirds majority required in the Senate, that is a pipedream unless smoking-gun evidence is produced.[2] So, there might be at least three years of “Breaking News” left to go. Whoop-de-doo.

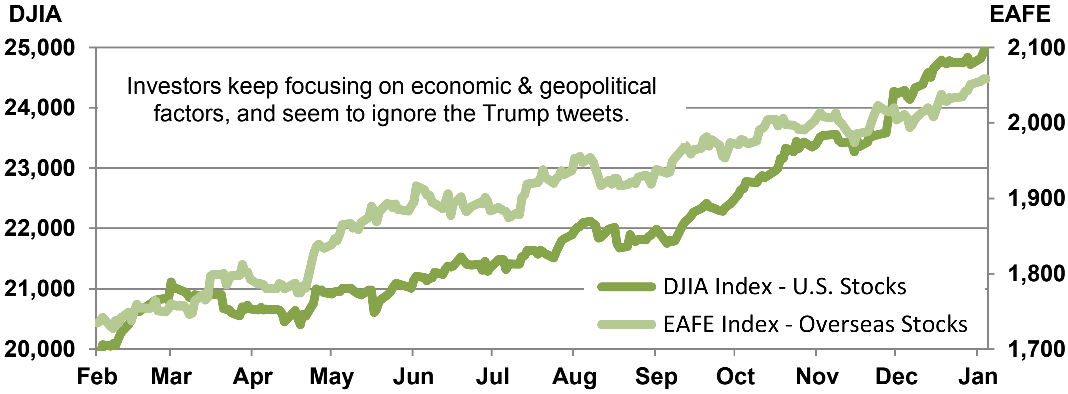
Thankfully for investors, the chaos inside and around the Trump administration hasn’t yet infected economic and geopolitical matters that can impact financial markets. Whether it is the result of inaction, distraction, or confusion, many of the prior national and international issues have levelled off or receded. This might help to explain why stocks in general keep doing well (**Chart 2)** without much volatility at all (**Chart 3**), even on days where there isn’t much market-specific news (corporate profits, mergers, strategic announcements, etc.).

[1] President Clinton was impeached by the U.S. House of Representatives on December 19, 1998 but still served out the 13 remaining months of his term since he was not convicted by the U.S. Senate.

[2] For President Nixon, it was a set of audio tapes that he made for posterity that provided the smoking-gun. Nixon quit, got out of Washington, and was pardoned by President Ford before impeachment and conviction could be voted upon.

Chart 2:

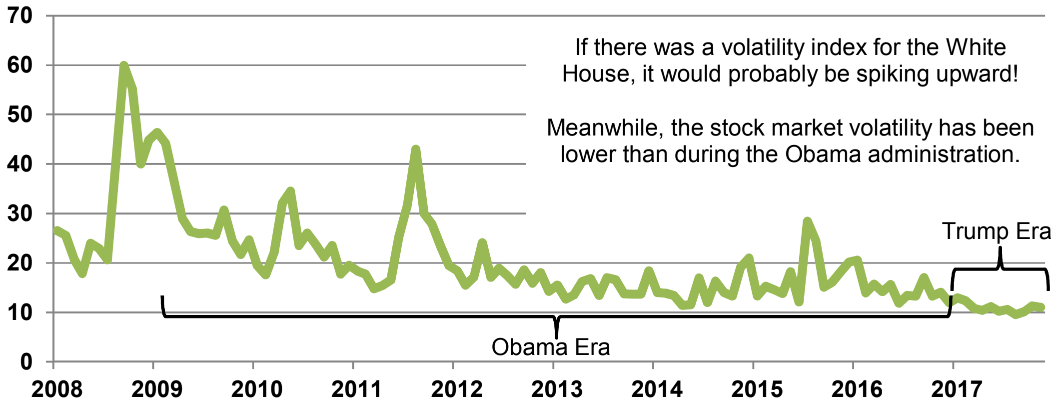
U.S. & Global Stock Market Performance during Trump Administration



Source: Bloomberg Finance L.P. as of 1/5/2018

Chart 3:

S&P 500 (Stocks) Volatility Index



Source: Bloomberg Finance L.P. & The Chicago Board Options Exchange as of 1/5/2018

With respect to the U.S. economy, inaction though an inability to pass much fiscal legislation might actually help the economy. Even though tax reform passed in December, there has been a dearth of spending-related bills. Often these bills get weighed down with all sorts of added compromises, exceptions, or special interest handouts to get all the votes needed. The economy ends up being micro-managed, which is far from optimal.

Often historically, an inability to pass legislation and to micro-manage the economy actually helps the economy.

The Trump administration's inaction or distraction at the domestic level contrasts with the "proactive confusion" with respect to foreign policy. Prior to Trump's election, there were a number of darkening clouds overseas. While there are still clouds, there geopolitical weather has brightened a little.

Many aspects of U.S. foreign policy do not require bipartisan support, allowing the Trump administration be very proactive.

This pro-activeness appears to have confused a number of belligerent foreign countries into a state of more "peaceful paralysis" despite the rhetoric.

With all the talk of Russia looking to co-opt the U.S. into advancing Russian interests, the net result on Russia has been a continuation of sanctions, a re-affirmation of the American opposition to the annexation of Crimea, and a decision to arm the Ukrainian army fighting Russian-backed rebels in eastern Ukraine.

For China, news of clandestine military expansion in the South China Sea and harassment of the Japan's coast guard in the East China Sea have eased off (though not entirely). And, things have quieted down on the cyber-theft front. Perhaps trade threats have China on the back foot, unsure as to how far they can push things before President Trump reacts adversely.

In Iran, the lack of economic progress following the lifting of sanctions related to the nuclear deal[3] has tested the patience of the public dealing with unemployment and inflation. It could be much more difficult to fight Middle East proxy wars when losing the support of one's own citizens.

Finally, North Korea continues to be a flashpoint, but its missile and nuclear advancements appear to have been mostly expected by the markets. A lack of pre-emptive engagement by the Obama, Clinton, and the two Bush administrations contributed to the *fait accompli*. Standing back from the recent incendiary rhetoric from both sides, North Korea looks like it has fully played its hand for now. A resulting cold war-style standoff looks to maintain the status quo into perpetuity. This is essentially stability by another name. In the meantime, recent sanctions look like they are beginning to bite judging from North Korea's rapprochement with South Korea regarding the upcoming Winter Olympics.

Geopolitically, President Trump's first year is reminiscent of the Reagan era. Reagan might have been much more elegant and statesmanlike than the current President, but the ability to confuse belligerent foreign countries into a state of "peaceful paralysis" appears to be something that they share in common.

This is not to conclude that the next three years will be an economic and geopolitical walk in the park. But, at least the last year has been a pleasant surprise.

[3] Much of the economic progress is related to the reluctance of foreign companies and financial institutions to fully engage with the Iranian economy for fear of rhetorical attack or economic reprisals from President Trump. Additionally, there are still American sanctions related to terrorism and the diplomatic impasse beginning with the 1979 hostage crisis.

Model Portfolio Update[4]

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 either the investment holdings or the asset allocation in The Charter Group Balanced Portfolio during the month of December.

No portfolio changes were made in December.

The biggest negative impact on the Balanced Portfolio during 2017 was the persistent strength of the Canadian dollar. Most of that bullishness might be attributed to a very strong 2017 2nd quarter for Canadian economic growth. There could also be some latent hope that the factors which led to that strong quarter are still present despite some de-acceleration in economic growth during the final half of the year.

The persistent strength of the Canadian dollar had a negative impact on the portfolios during 2017.

The main factor driving that 2nd quarter growth was retail spending. The question going forward is whether the high level of retail spending can be sustained. That might be a major challenge if interest rates continue to edge higher. Also, if it was partially the real estate euphoria that contributed to the increased consumer confidence, will the new

However, if the Canadian economy is not as resilient as many believe, the Canadian dollar could face difficulty.

[4] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 1/5/2018. 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.

mortgage qualification rules place a damper on the willingness of debt-laden homeowners to spend?

Recent comments from the Bank of Canada suggest that there could be a number of interest rate hikes over 2018. Faced with risks to the housing market, and the fact that the housing market's contribution to economic growth has increased, the Bank of Canada might be more reluctant to hike than most economists expect. This has the potential of keeping a lid on the value of the Canadian dollar versus the U.S. dollar.

Going forward, we will need to keep tabs on NAFTA negotiations and the potential impact on the Loonie and Canadian stocks. Right now there is no viable Plan B if talks fail and the agreement is terminated. The best hope would be for a number of specific bilateral trade agreements between Canada and the U.S., but it would be difficult to start that process before the final fate of NAFTA is resolved.

Below is the full year 2017 performance of the asset classes that we have used in the construction of The Charter Group Balanced Portfolio (**Chart 4**).[5]

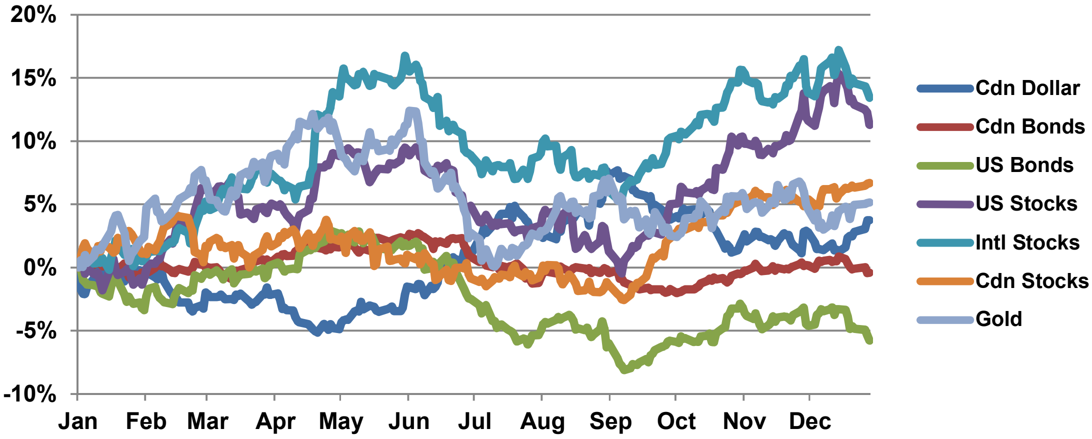
Will new mortgage rules impact consumers enough to reduce the number of interest rate increases in Canada during 2018?

If NAFTA is watered-down or terminated, will this impact the Canadian economy's ability to withstand interest rate hikes?

Currency traders focusing on the Canadian dollar will be watching these issues closely.

Chart 4:

2017 Performance of the Asset Classes (in Canadian dollars)



Source: Bloomberg Finance L.P. as of 1/5/2018

[5] 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[6]

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

[6] 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, I encourage you to email me at mark.jasayko@td.com or call me directly on my mobile at 778-995-8872.

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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 January 5, 2018.

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.

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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.