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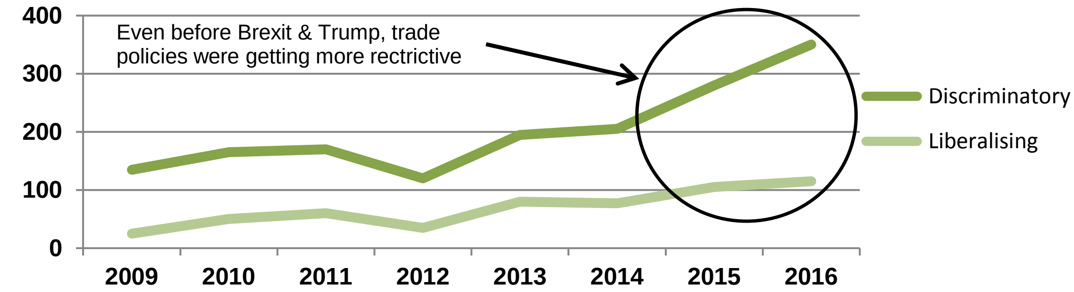
Economic & Market Update

Globalism, Globalization, and the Not-so-Brave New World

One clear message from the events of 2016 is that the tide of "globalism" is ebbing. Globalist leaders lost a very significant referendum (Brexit) and very significant election (the U.S. Presidential and Congressional campaigns). That said, on some measures "globalization" peaked back in 2009 (**Charts 1 & 2**). From that perspective, it appears that voters are merely catching up to a trend that has been in place for eight years. But, globalism and globalization are two different things.

Recent defeats for globalists may speed up the trend of de-globalization that has been in place since 2009.

Chart 1:
G20 Trade-Policy Measures Implemented



Source: Centre of Economic Policy Research as of 1/5/2017

Globalization occurs when opportunities are presented by changes in global order.

Globalization is a natural economic response to opportunity usually brought on by a change in geopolitical order. We first saw this on a significant scale between the Roman Empire and China's Han Dynasty along the Silk Road route. Eventually it was the Ottoman Empire that utilized the Silk Road. Later it was the gathering naval strength and the commercial maritime capabilities of the colonial empires that spawned the creation of the British East India Company and the Dutch East India Company in the 1600's and 1700's. Growing imperialism and industrialization in the 1800's dramatically increased trade along established sea routes. Then it was the guarantees provided by U.S. naval strength following World War II that pushed global trade to new heights. Finally, the end of the Cold War provided the impetus for new trade treaties as well as increased access to low-cost labour that established the current era of global trade.

Through the history of globalization, governments, companies, and individuals saw the opportunities and naturally took advantage of them.

Globalism is a political ideology often espoused by those that have a self-interest.

In contrast, globalism is a form of political ideology championed by certain politicians, corporate leaders, and prominent individuals from an elite class.[1] Often the ideology will push an agenda of unfettered movement of financial, real, and human capital that is beyond the appetite of the general domestic population.

Global trade is generally very positive for participating countries. It allows them to focus on exporting goods and services that they are good at producing and to import goods and services where they lack expertise.[2] Most of us saw the benefits of globalization,

[1] In recent years, members of the globalist group of politicians, corporate leaders, and individual elites have been referred collectively to as "Davos Man", named after the World Economic Forum held annually in the Swiss ski resort town of Davos. In recent years, delegates tended to have a self-interest-benefit or ideological affinity with respect to globalism.

[2] This is based on the theory of "comparative advantage" developed by the economist David Ricardo in 1817.

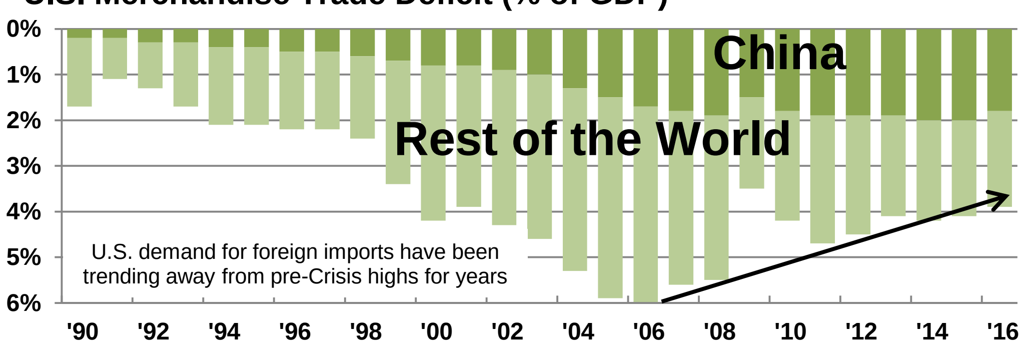
especially over the last few decades. For proponents of globalism, the campaigning and lobbying strategies highlighted this. And it mostly worked up until last year.

Globalists may have pushed things too far too fast by not considering the costs and displacement caused rapid change.

However, as globalism pushed for faster and faster change, resistance developed. Concerns regarding job stability and financial security begin to grow in the population as people witnessed more cases of displacement and imbalances caused by outsourcing, international corporate and individual tax avoidance[3], and open immigration. We saw this resistance in the results of the Brexit vote and the November U.S. elections. We may see more of it in forthcoming French and German elections in 2017.

If anything, the recent defeats of globalism at the ballot box should speed up the process of de-globalization that we have seen since 2009. Despite the cheerleaders for globalism in the Obama administration and in European governments, it has been harder to sign trade agreements since the Global Financial Crisis (**Chart 1**) because of the anemic recovery. Many countries lacked the confidence to sign binding agreements as they were unsure of their economic foundations and vulnerabilities. Much of the recovery since 2009 was financially-engineered with very low cost credit and printed money which gave it an artificial feel in contrast to the robust stretch of economic growth from the 1980's up to the Global Financial Crisis.

Chart 2:
U.S. Merchandise Trade Deficit (% of GDP)



Source: U.S. Census Bureau & U.S. Bureau of Economic Analysis as of 1/5/2017

This lack of confidence may have also contributed to a significant rise in geopolitical belligerence from countries that don't have strong civil, legal, and democratic institutions. As the overall pie of economic wealth has stagnated since 2009, countries such as China and Russia have made land-grabs and territorial claims that are beyond the current international legal frame work in an effort to shift attention away from the economy and toward issues that inspire nationalistic fervour.

[3] This is not the same thing as tax "evasion" which is considered illegal.

We may be moving from a phase where fewer trade agreements are signed to a new phase where trade agreements are renegotiated or scrapped all together. This would be a net negative for the global economy but could benefit particular regions, industries, and currencies.

More restrictive trade and immigration will help some investment markets and hurt others.

In the short to medium term, the U.S. could benefit as financial capital (cash held offshore to defer taxation) and operating capital (production capacity) are repatriated. Further, this may attract more foreign capital into the U.S. as foreign investors perceive opportunities resulting from an increase in economic growth relative to their home countries.

The U.S. and the U.K. could see some short to medium term net benefit.

Once of the costs of the Brexit are accounted for, the U.K. may be in a position to grow economically again aided by an ability to manage their own trade policies as opposed to submitting to the bureaucrats at the E.U. Any net loss with respect to exports to the Eurozone could be made up with by securing one-off deals with other countries. Brexit has the potential to change the terms of trade, but it doesn't make U.K. export products any less desirable.

Developing countries that rely on an "export model" economy and on issuing U.S. dollar-denominated debt might be hurt.

Countries with the most to lose might be those heavily reliant upon the "export model." They often have high surplus trade balances, low-cost labour, and have pushed the limits of existing trade treaties with respect to dumping exports. These countries could include China (backlash against aggressive treaty interpretations), India (less outsourcing from developed countries), and Mexico (target of U.S. election rhetoric).

Also, even though the U.S. Federal Reserve Board claims that they only focus on the U.S. when formulating interest rate policy, there has been a consensus in recent years that they have taken international economies into account (an indication that some of the influential members might be undeclared globalists). If there is indirect political pressure to consider implementing higher interest rates, this could really wallop the developing countries that have been issuing debt in U.S. dollars which has helped to keep the debt cost (interest payments) low over the last decade.

Our Model Portfolios already had overweight positions in the U.S. and an absence of any exposure to the developing countries. If anything, the shift in the tide of globalism may hasten the trends for which the Model Portfolios were already set up.

Model Portfolio Update[4]

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

	Target Allocation %	Change
Equities:		
Canadian Equities	15	unch
U.S. Equities	34	unch
International Equities	11	unch
Fixed Income:		
Bonds	28	unch
Alternative Investments:		
Gold	7.5	unch
Commodities & Agriculture	2.5	unch
Cash	2	unch

No changes were made to The Charter Group Balanced Portfolio's target asset allocation during December but there were some changes made to the individual investments.

No changes were made to the Balanced Portfolio's overall asset allocation during December.

Methanex Corp. was sold on valuation issues after its price had risen by over 70% from the lows of this summer. The position in Saputo Inc. (Dairyland) was sold partly on valuation as the stock price rose through 2016 (confounding most brokerage-firm analysts by doing so), and because of an increase in recent insider-selling.[5] Additionally, we have plenty of other food and agriculture investments, so it was an opportunity to trim our exposure to the sector which has done well as a whole over the last year.

However, we did sell the stock we held in Methanex and Saputo and purchased Air Canada and Canadian Western Bank.

Air Canada was purchased with a few things in mind. First, jet fuel prices should be relatively contained as the general oil market is still subject to the prospect of significant increases in supply if oil nears $60 USD (jet fuel is Air Canada's largest expense).

[4] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 5/1/2016. 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.

[5] Source: Bloomberg Finance L.P., Top Holders as of 1/5/2017

Second, the airline is in a period of relative labour peace (labour is Air Canada's second largest expense). Third, recent fleet and international route expansion is well-targeted in order to maintain good passenger loads on flights with relatively high profit margins.

The position in Canadian Western Bank was established in anticipation that the worst may be over for the Albertan economy which is where 40% of the bank's entire loan book is located.[6] It is very unlikely that the Albertan economy will bounce back to its former glory anytime soon, but even an incremental recovery will benefit. Additionally, the bank has learned the lesson of being overly dependent upon oil by establishing a commercial finance beachhead in Ontario via a couple of recent acquisitions.

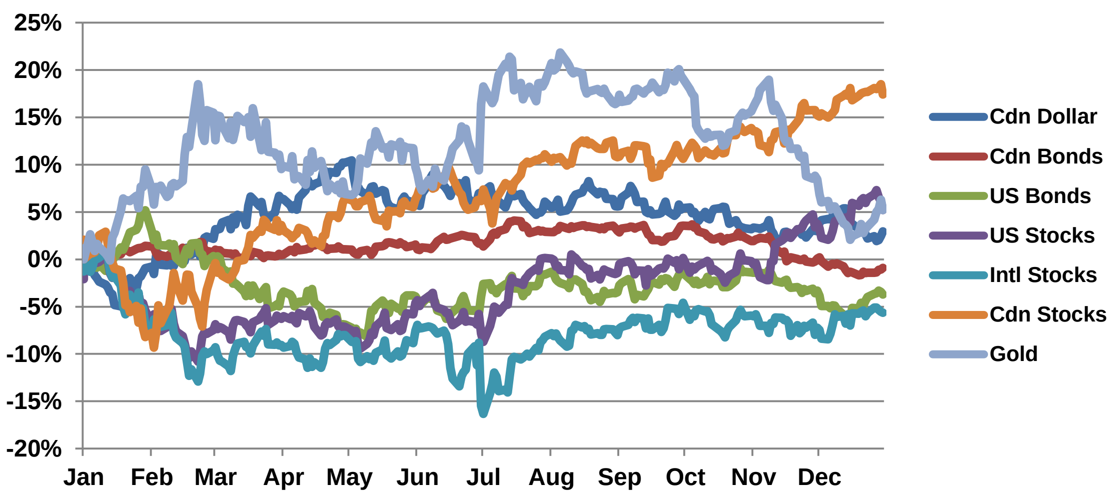
Below is the 2016 performance of the asset classes that we use in the construction the Charter Group Balanced Portfolio (**Chart 3**).[7] We can see that to two major contributors to the Portfolio's results for the year were Canadian and U.S. stocks. Because of the significant allocation to these two asset classes, it more than offset the lagging performance from bonds and international stocks.

The Balanced Portfolio's results in 2016 were driven primarily by Canadian and U.S. stocks.

Weakness in the Portfolio came from bonds and international stocks.

The effect of the Canadian dollar was generally neutral for the year.

Chart 3:
2016 Performance of the Asset Classes (in Canadian dollars)



Source: Bloomberg Finance L.P. as of 1/5/2017

6 Senger, Emily (July 5, 2016). "How Canadian Western Bank is diversifying away from oil money." www.canadianbusiness.com

7 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[8]

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. Canada's Economic Growth (Oil)	Moderate	Negative
5. U.S. Fiscal Spending Stimulus	Medium	Positive
6. U.S. Foreign Policy Uncertainty	Medium	Negative
7. Massive Stimulus in China	Medium	Positive
8. Short-term U.S. Interest Rates	Light	Positive
9. Japan's Money Printing	Light	Positive
10. Europe's Money Printing	Light	Positive

[8] 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.

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The Charter Group at TD Wealth 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, BC 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, 2017.

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