TD Wealth

Private Investment Advice

The Charter Group Monthly Letter

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Economic & Market Update

Will the "Trump versus Clinton" Circus blow up the market?

Since the summer of 2015 the news cycle has been dominated by the U.S. presidential campaign. Over the last few decades, campaign coverage has been increasing both in terms of duration and intensity. However, in the run-up to the election on November 8th, it has reached an unprecedented level. The implication is that the occupant of the White House is so important to the direction and economic health of the U.S. that every detail, regardless of how miniscule, cannot go unreported.

The news media makes it appear that the U.S. presidential election is the only thing that matters.

This contrasts with the historical record showing that it is often the Office of the President that constrains and molds the President, rather than the other way around.

What begins as a honeymoon full of hope and change always gets countered by the other law-making bodies in Congress and by the magnitude of outside events. President Lyndon Johnson was famous for lamenting about why he couldn't resolve the war in Vietnam if he was supposedly the most powerful man on Earth.

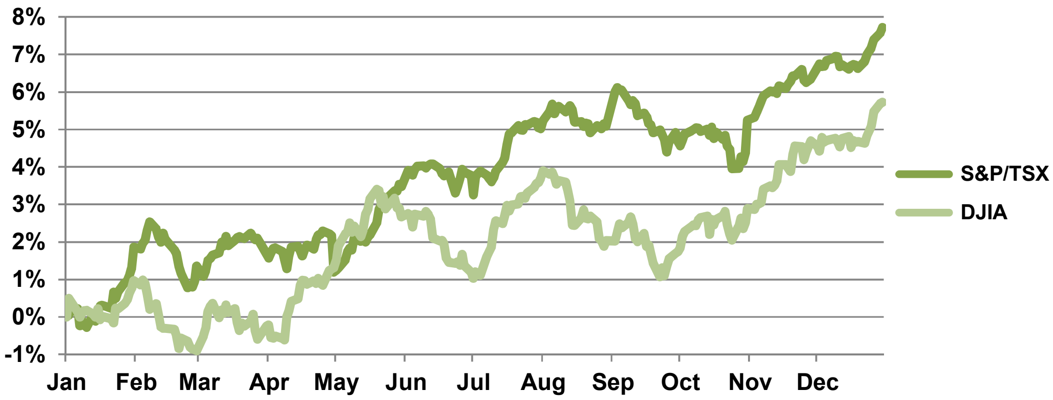
The President of the United States is not as powerful as most people realize with respect to economic issues.

Even though everyone will soon discover that the President won't be able to change things that dramatically, the first year of the "Presidential Cycle" has been relatively kind (**Chart 1**) (except for Nixon and Eisenhower who were hit by the stock markets after their initial elections *and* re-elections). Seven of the last eight post-election years were positive (the only down year being 2001 which was hampered by the post Dot-com Bubble as well as 9-11).

Existing conditions, outside influences, Congress and constitutional limitations restrict the ability of a President to make many significant economic impacts.

Chart 1:

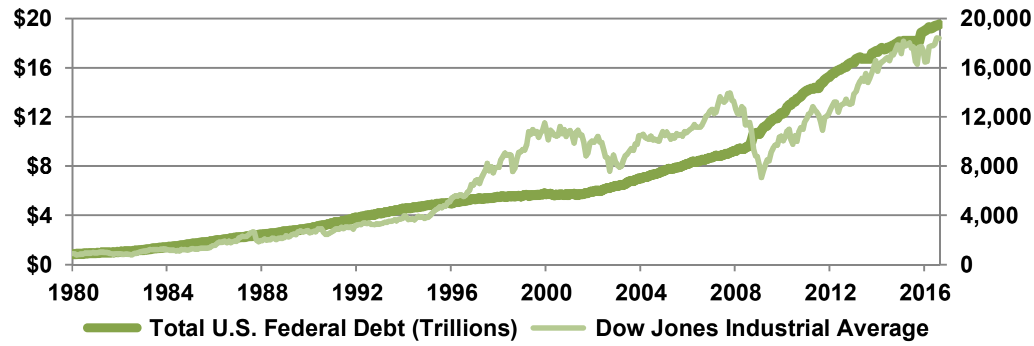
Post-U.S. Presidential Election Years - Seasonal Since WW2



Source: Bloomberg Finance L.P. as of 10/1/2016
DJIA = Dow Jones Industrial Average, S&P/TSX = S&P/TSX Composite Index

Chart 2:

U.S. Federal Debt & U.S. Stocks: Growth Since 1980



Source: Bloomberg Finance L.P. as of 10/1/2016

If we ignore their differences with respect to tax policies, Trump and Clinton share a number of very significant economic similarities. Both like to spend and both are amenable to adding to the Federal debt. That's good news for stocks as long as the increased debt doesn't have to be paid back anytime soon (in the long-term, the high debt burden could lead to inflation and slower growth). If we look back over the last 35 years, the correlation between the growth in debt and the rise in stock prices has been high (**Chart 2**). More Federal spending usually leads to more economic activity which will lead to more consumer-spending, helping companies to increase revenues and earnings. Higher earnings usually factor into higher share prices for those companies.

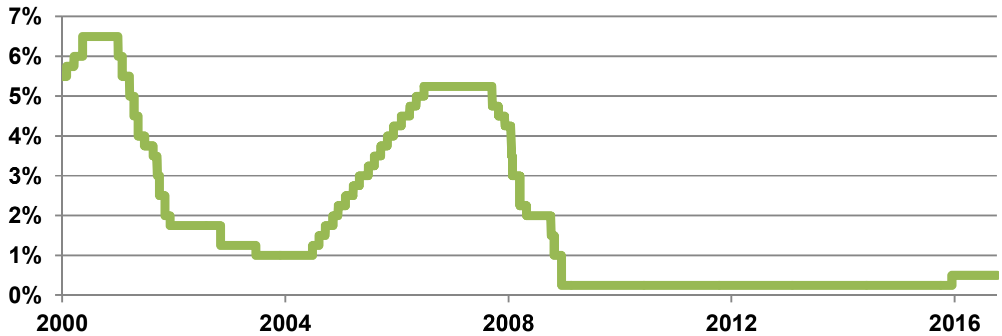
The economic similarities between Clinton and Trump outweigh their differences.

Both like spending, using debt, and the opportunities that low interest rates provide.

With respect to interest rates, Trump is on the record of saying that he likes low interest rates which will help to facilitate borrowing. While he has stated that he would replace Janet Yellen, the current Chair of the U.S. Federal Reserve Board, when her term is up in January 2018, she is known as a 'dovish' central banker who prefers to err on the side of lower rates. However, Trump sees her as assisting Obama and, in turn, Clinton's campaign with the currently low U.S. Fed Funds rate (**Chart 3**). I suppose Trump just wants his "own" low-rate central banker as Chair. In any case, it appears that either candidate would encourage lower interest rates for longer, which is good for stocks.

Chart 3:

U.S. Fed Funds Rate (Upper Bound)



Source: Bloomberg Finance L.P. as of 10/1/2016

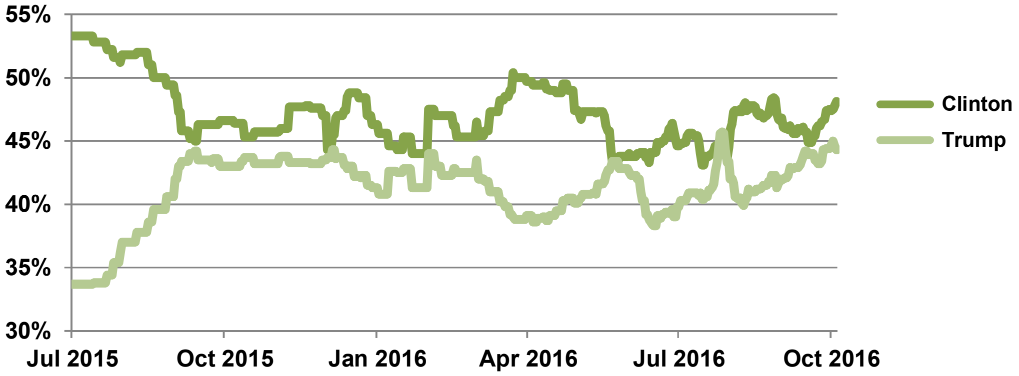
It is also important to note that a lot of the campaign rhetoric from both candidates is just that: rhetoric. The realization of things like a border wall or significant increases in social spending would require the cooperation of the U.S. Senate and the House of Representatives. Given the divided nature of the U.S. Congress, it is wishful thinking that any bold promises will be achieved. Investors have historically preferred this kind of gridlock as generally reduces legislative uncertainty. Gridlock was good for stocks for the last six years and provides a check and balance on the next President.

The U.S. Congress usually gets in the way of a President's most ambitious plans.

At this stage, polling indicates that Clinton has the upper hand over Trump (**Chart 4**). If that holds through to the election, we would get a Presidency that would be marginally more trade-friendly which would be a positive for stocks and very important for Canada economically (with the cheap Canadian dollar, Canada needs easier access to markets in order to sell those cheaper-priced Canadian goods and services). On a net basis, this would be positive for Canadian stocks. One drawback would be Clinton`s pandering to the left-wing of her party which is very protectionist. As a result, it might be hard for her to be the champion for North American free trade that Bill Clinton was.

Chart 4:

Real Clear Politics 2016 Presidential Poll



Source: Bloomberg Finance L.P. as of 10/1/2016

One possible negative of a Clinton Presidency would be the likelihood of higher pharmaceutical prices in Canada. Clinton has the U.S. drug companies in her sights with respect to price gouging. When those U.S. drug companies negotiate with the various Provincial drug plans in Canada, they may be forced to become much more aggressive to make up for the potential loss of significant revenue in the U.S.

The U.S. presidential election itself may underwhelm the market. Instead, some of the short-term risks that may be indirectly related to the election have the potential to surprise. Russia (regarding Eastern Ukraine, Crimea, Syria, computer hacking), China (in the South China Sea and East China Sea), and North Korea (missile and nuclear testing) might see the last days of a Obama Presidency as an opportunity to cause some geopolitical trouble. It's unlikely that Obama wants to become stuck in some quagmire in his last few weeks in office. Although it is only a small probability, a serious development on one of these fronts could blindside the markets. The window for such potential geopolitical opportunities is small as both Trump and Clinton sound a lot more hawkish than Obama has been with respect to the use of the military.

Although a small probability, international geopolitical events could have a very significant impact on markets during U.S. presidential elections and the transition to a new administration.

Longer-term, the markets may have to deal with the fallout from an excessive debt burden and from the damage that low interest rates are doing to U.S. pensions and international financial institutions. Neither candidate will be able to do much about these issues.

Model Portfolio Update[1]

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 or the specific investment holdings during September.

No changes were made to the Balanced Portfolio during September.

The Balanced Portfolio is continuing its relatively historical conservative stance. The Dow Jones Industrial Average has not seen at least a 20% correction since bottoming in March 2009, seven and a half years ago (The closest to a 20% correction was a 16.82% peak-to-trough move in the summer of 2011).[2] As a result, we want to be a little cautious here. Additionally, valuations of stocks in Canada and the U.S. are stretched in terms of earnings. So, unless earnings rise, we could see some pressure on share prices.

The Balanced Portfolio is still maintaining a conservative stance.

Markets bounced around in September, but mostly ended where they began.

September saw considerably more volatility across most asset classes than in July and August. However, despite some up and down moves, the major asset classes were little

[1] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 6/1/2016. 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 seven portfolios ranging from conservative to aggressive: Very Conservative, Conservative, Balanced Income, Balanced, Balanced Growth, Growth, and Aggressive Growth.

[2] Source: Bloomberg Finance L.P.

changed for the month. As a result, there weren't any asset classes that substantially added to or detracted from the Balanced Portfolio's results.

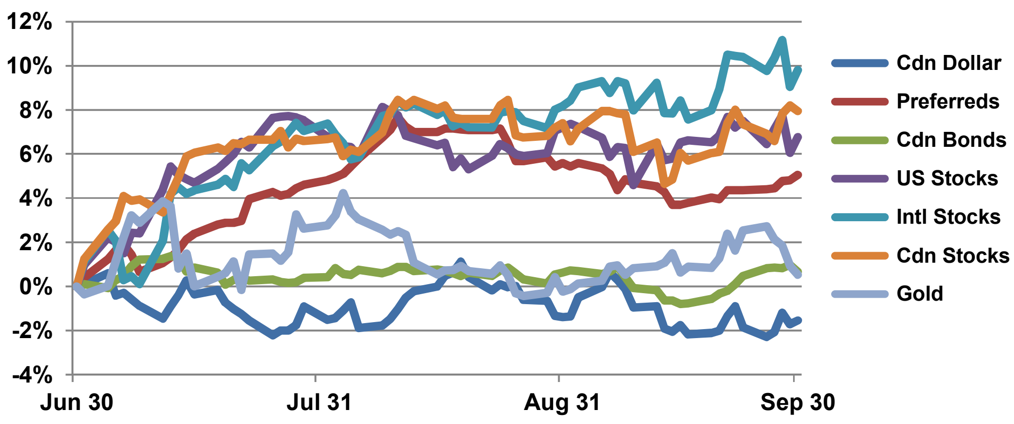
Over the third quarter (July, August & September) international stocks, U.S. stocks and Canadian stocks made the biggest contribution to performance, especially early in the quarter. The heavier tilt towards U.S. stocks also allowed the Portfolio to benefit from the Canadian dollar which was down about 2% over the quarter (**Chart 5**).[3] As we are still bearish on the near- to mid-term potential for the Canadian dollar, we are hopeful that we will see some more positive contribution resulting from the Portfolio`s currency exposure into 2017.

International, U.S. and Canadian stocks were the big contributors during the 3rd quarter.

Looking forward, October is historically a better month for stocks than September, but it is also known as a month of surprises (this reputation stems mostly from Black Thursday in 1929 and Black Monday in 1987). In most cases the month is positive, however, on rare occasions market psychology can take over in response to issues that have either been simmering beneath the surface for a while or appear suddenly. Again, it is unlikely, but something to be kept in mind with respect to issues such as slow economic growth, stagnant corporate earnings, or international geopolitical crises.

October is historically a better month than September, but because of October's ability to surprise, it's important to keep a closer eye on risks.

Chart 5:
3rd Quarter 2016 Performance of the Asset Classes (In Cdn dollars)



Source: Bloomberg Finance L.P. as of 10/1/2016

[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; Preferred shares are represented by the iShares S&P/TSX Canadian Preferred Share Index (CPD); Canadian bonds are represented by the iShares DEX Universe (Canada) Bond Index (XBB); U.S. stocks are represented by the iShares 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 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. Short-term U.S. Interest Rates	Significant	Positive
3. Canada's Economic Growth (Oil)	Moderate	Negative
4. Canadian Dollar Decline	Moderate	Positive
5. Long-term U.S. Interest Rates	Moderate	Negative
6. Negative Rates - Europe & Japan	Medium	Negative
7. Japan's Money Printing	Moderate	Positive
8. Europe's Money Printing	Medium	Positive
9. Massive Stimulus in China	Light	Positive
10. Intl. Bank & Pension Stability	Light	Negative

[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

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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 October 1, 2016.

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