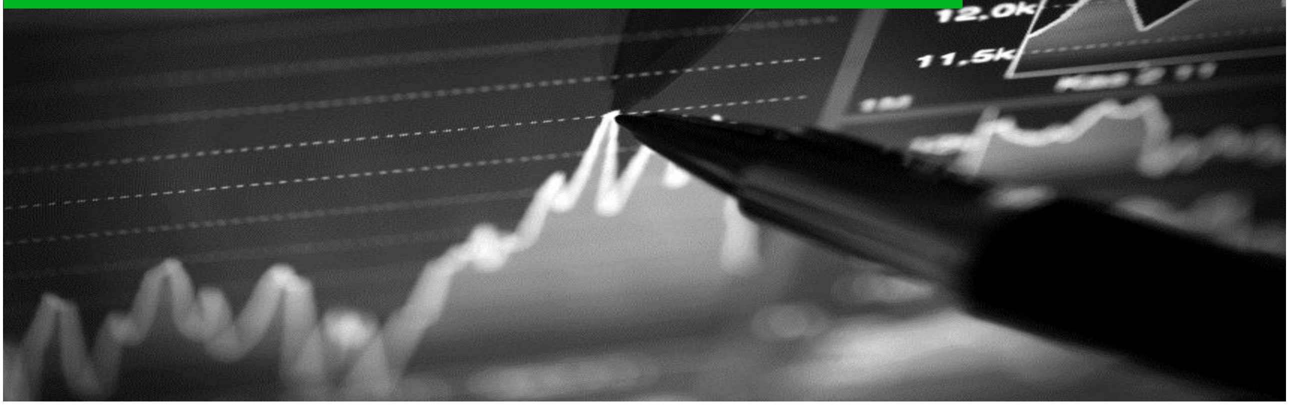
TD Wealth

# The Charter Group Monthly Letter

## March 2018




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


## Economic & Market Update

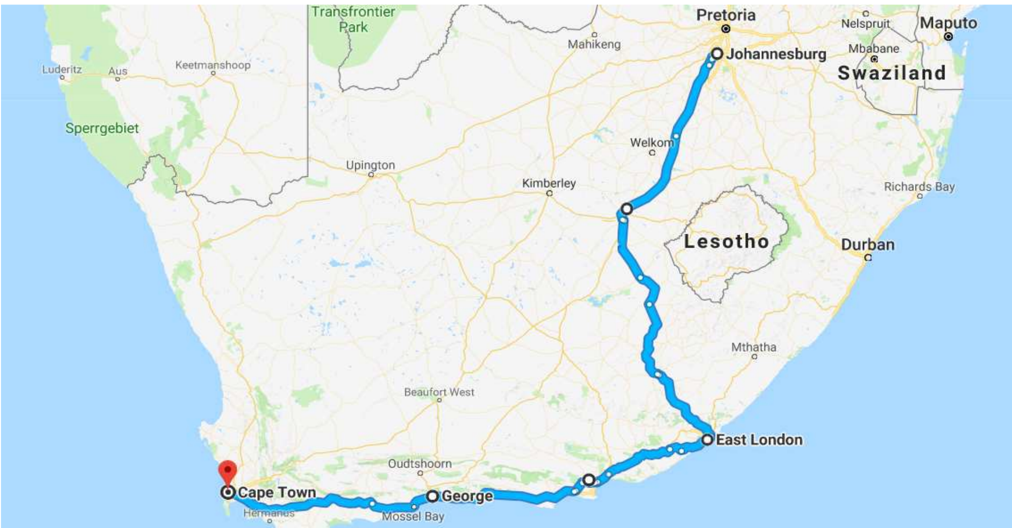
### A South African Lesson for the Loonie

Source: Mark Jasayko

My Cathay Pacific flight from Johannesburg to Hong Kong just crossed the east coast of Madagascar and is heading into the great expanse of the Indian Ocean. With dinner service complete, there was no better time to write down a few notes about my visit to South Africa.

**A country with natural economic advantages can't afford to become complacent without risking the strength of its currency.**

Socioeconomically, politically, and geographically, South Africa is a land of contrasts. Driving from Johannesburg to Cape Town via the coastal route through the Cape provinces, one is presented with many of these contrasts. The goldfields south of Johannesburg give way to a series of mountain ranges which need to be traversed. The dry air becomes cool and damp through the mountain passes and then becomes distinctly humid as the warm Indian Ocean currents inundate the coast. Then, driving westward along the coast towards the Cape of Good Hope, the air slowly dries out again as the colder Atlantic Ocean currents create a Mediterranean-type climate zone.




Source: Google Maps

Global headlines have focused on a drought impacting Cape Town. The dry climate there is partly responsible. However, the other aggravating factors are politics and an increasing population. The western part of the country has different political leanings than does the main population centre around Johannesburg. As a result, the governing party (The African National Congress, or ANC) does not receive majority support in the Western Cape. Hence, there is a lack of incentive to deploy federal funds to expand reservoirs and build desalination plants in order to convert sea water into fresh water. (Canada is clearly not the only country with a fractious east-west political divide!)

**South Africa has regional political divisions just like Canada.**

South Africa has a number of tremendous economic advantages. Natural resources are plentiful, especially gold, platinum and palladium. There is also some excellent transportation infrastructure. The coast-to-coast motorways are as good as they are in North America. Numerous modern airports, port facilities, and railways keep people and cargo moving within the country and to international destinations. Finally, there is a notable base of knowledge capital supported by a number of world-renowned research universities. Although classified as a developing economy, South Africa is in the First World when it comes to areas such as technology and medicine.

**Just like Canada, South Africa has some tremendous economic advantages, including natural resources, infrastructure, and an educated workforce.**

Despite all these advantages, South Africa's economic growth has sputtered since the Global Credit Crisis in 2008, and its currency, the rand, has weakened considerably (**Chart 1**). My last visit to South Africa was in January 2010. Back then I thought I was getting a great deal on the currency conversion. Food and accommodation were very affordable then. This time, things were significantly cheaper!

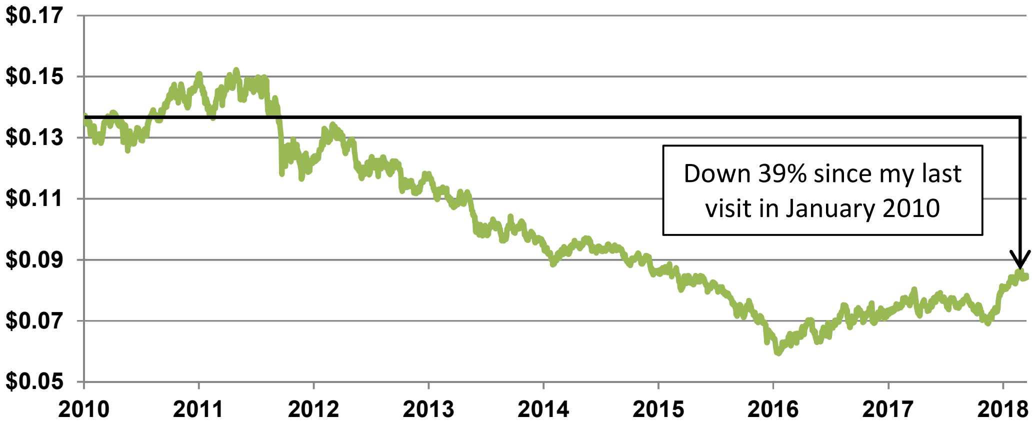
**Despite these economic advantages, South Africa's currency, the rand, has declined.**

Some might be quick to suggest that this has something to do with the country's socio-economic disparities. South Africa has the second-worst income inequality ratio in the world[1] (behind Lesotho, which is a country landlocked entirely within the borders of South Africa). However, income inequality has remained mostly constant over the last decade, so it doesn't really explain why economic output has worsened or why the rand has collapsed.

Instead, the likely culprits for South Africa's malaise are politics, economic policies, and trade realities.

**Chart 1:**

**South African Rand (Valued in U.S. Dollars)**




Source: Bloomberg Finance L.P. as of 3/15/2018

In terms of transparency, South Africa ranks 71st out of 180 countries[2] (Canada ranks 8th by comparison), but corruption may feel worse than that because of intense press scrutiny which is much more prevalent than in other developing countries where the press is more controlled. In recent years, the level of scandal is grown considerably because of questionable political leadership and a lack of checks and balances with respect to the government partnering with private interests. All of this contributes to heightened uncertainty and confusion and tends to reduce the level of investments made by individuals, domestic corporations, and international corporations.

**Lack of political and economic transparency scares away foreign investors.**

**South African economic policies, designed to appeal to a particular political support base, were not well thought out.**

---

[1] U.S. Central Intelligence Agency World Factbook.
[2] https://www.transparency.org/country/ZAF

Economic policies have been less than ideal. Although it is understandable that the government wants to even out economic disparities, focusing on issues like farmland expropriation are economically damaging for the country as a whole. Current large-scale farming is integrated into established supply chains in order to achieve economies of scale in terms of production. Dividing up farmland loses those advantages. Plus, only a sliver of the impoverished population is involved in agriculture. What most of that population wants and needs are better living conditions and job prospects that offer economic and geographic mobility. Instead, by focusing on expropriation solutions in general, potential investors in the economy become less confident about committing their capital.

**South African economic policies, designed to appeal to a particular political support base, were not well thought out.**

Finally, primarily because of geographic location, South Africa lacks a major trading partner. China, which is an ocean away, is its largest and accounts for about 15% of exports. The U.S. is next at 8% and then Germany and Japan at 6%. Its geographic neighbours offer only very limited export potential, usually focusing on agriculture instead of exports that include value-added manufactured goods or high-margin metals.

**South Africa is stranded geographically from major industrialized trading countries.**

The challenges that the rand faces are similar to many of those that impact the Canadian dollar. Unfortunately, Canada has seen an increase in the level of scandal and the distracting media attention that focuses upon it. It is not confidence-inspiring for foreign investors.

**Many of the issues impacting the South African rand are similar to issues in Canada that could impact the value of the Canadian dollar.**

Also, recent Canadian economic policy has shifted in a direction that is less business-friendly. In a hasty effort to increase wealth re-distribution through taxation, many of the side effects were not given much attention.

Finally, on the trade front, Canada's upside is limited and there are questions as to whether we are doing everything possible to minimize the damage. Trading across a shared border with an economic juggernaut is something South Africa can only dream of. Canada needs to manage its opportunity with the U.S. and resist the temptation of thinking that faraway markets run by an assortment of regime types represent viable alternative export destinations. Heck, Canada's ability to move exports via rail or pipe to ports for shipping overseas is already beyond capacity which nullifies this "Plan B."

**Canada will need pragmatic political attention on these issues in order to mitigate unnecessary negative forces on the Canadian dollar.**

Unless a higher priority is placed on finding real solutions to these economic realities, the loonie is going to continue to fly into headwinds just as the South African rand has.

## Model Portfolio Update[3]

**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 investments or the asset allocation in The Charter Group Balanced Portfolio during February.

**No changes during February.**

Most of the positive contribution came from the positions in gold and bonds which helped to offset some of the dramatic declines in stock markets at the beginning of the month.

**The stock market selloff at the start of February had the biggest impact on the Balanced Portfolio.**

**However, the bond and gold holdings help to offset some of this impact.**

The stock market selloff looks like it was precipitated by two things. First, investors appeared to be looking well into the future and were contemplating how stocks might fare in the face of rising rates. Generally, rising rates make will make bonds look more attractive on a yield basis and could draw money out of stocks in order to buy bonds. Secondly, the significant spike in volatility hammered investment products that were wagering on a low-volatility environment persisting. These products have caught the

[3] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 3/1/2018. 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.

attention of investors over the last two years and the dollar values invested began to reach astronomical levels. Thus, when it looked like the peaceful low-volatility environment might be disrupted, investors began to rush in a panic toward relatively narrow exits, driving prices down dramatically. In many cases, they were also forced to sell quality investments to meet margin calls and shore up their portfolios.

**The selloff was initially precipitated by fears of rising interest rates.**

**Then things worsened when investors betting on low volatility began to incur significant losses.**

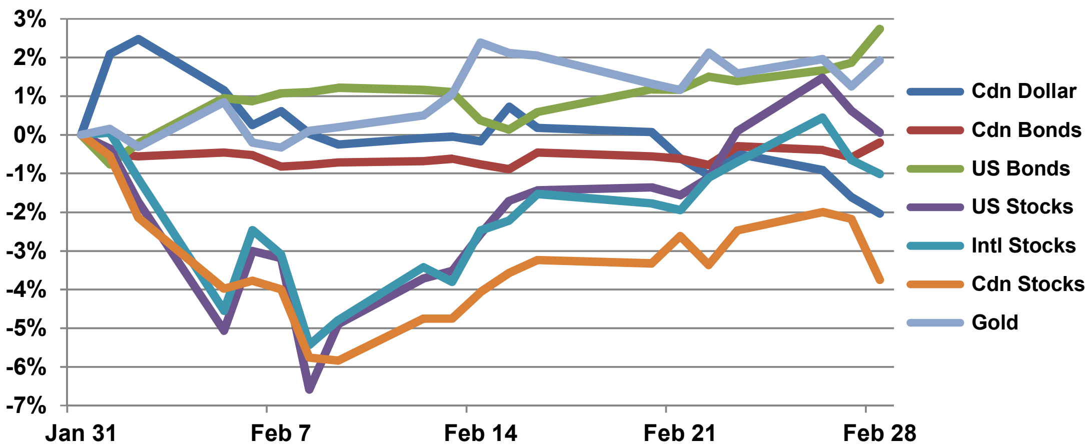
**We will need to keep an eye on the pace of interest rate increases going forward.**

Fortunately, the speculative aspects that drove the dramatic events lasted for only a short time. However, we will still have to keep an eye on the original catalyst which was the potential for higher interest rates. The consensus seems to agree that rates are heading higher. The debate is really over the rate of the interest rate increases. The markets may be able to digest a slow gradual incline. Any acceleration in the pace could cause more indigestion.

Below is the February 2018 performance of the asset classes that we have used in the construction of The Charter Group Balanced Portfolio (**Chart 2**).[4]

**Chart 2:**

**February 2018 Performance of the Asset Classes (in Canadian dollars)**




Source: Bloomberg Finance L.P. as of 3/1/2018

[4] 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[5]

| Issue | Importance | Potential Impact |
|---|---|---|
| 1. China's Economic Growth | Significant | Negative |
| 2. Long-term U.S. Interest Rates | Moderate | Negative |
| 3. East Asian Geopolitics | Moderate | Negative |
| 4. Canadian Dollar Decline | Moderate | Positive |
| 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. Middle East & Russia Geopolitics | Light | Negative |

[5] 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.

**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 March 15, 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.

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.