TD Wealth

The Charter Group Monthly Letter

December 2019

Issue 55

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

Economic & Market Update

Spendapalooza

On July 22nd, President Trump, Democrat Speaker of the House Nancy Pelosi, and Democrat House Minority Leader Chuck Schumer agreed to a federal budget deal and a lifting of the ceiling that caps the amount of debt that the U.S. Treasury is permitted to issue. To many analysts, including myself, this was hardly a surprise. Initially, Mr. Trump negotiated for a higher level of spending cuts. He then "acquiesced" and agreed to smaller spending cuts. "Trump" Republicans tend to be Borrowers & Spenders whereas most Democrats tend to be Tax & Spenders.[1] Notice the common denominator? Big spenders.

The U.S. Treasury has raised more than $1 trillion dollars since early August.

It would be reasonable to assume an incentive to spend it all before the November 2020 presidential election.

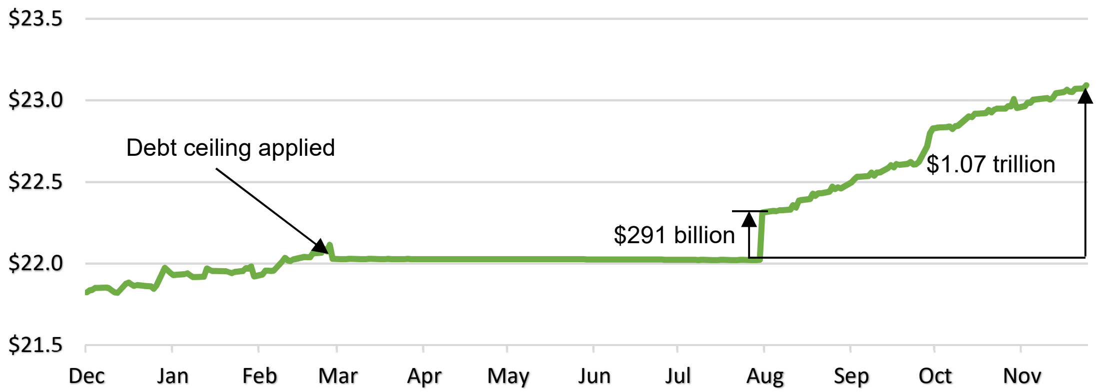
[1] The "Tea Party" Republicans were a fiscally conservative political movement within the Republican Party, but they have essentially dwindled to a caucus of one: Rand Paul, a Republican Senator from Kentucky. Not enough of an opposition anymore to turn the tide against the bipartisan temptation to spend.

Once Mr. Trump had sacrificed his apparent feigned desire for various spending cuts (the Oval Office meeting with Democrat leaders only lasted a few minutes compared to the month's long U.S. federal budget battles of yore), there was a photo op. And, that was it.

Not much resistance from either Republicans or Democrats with respect to raising the debt ceiling and ramping up spending.

Less than two weeks later, on August 2nd, the U.S. Treasury began issuing the bonds in order to raise the money which everyone was looking forward to spending. That day there was a Treasury auction for $291 billion in bonds, and by the end of November 2019 they had raised $1.07 trillion (**Chart 1**). Yes, trillion with a 'T'.

Chart 1:
Total U.S. Treasury Bonds Outstanding (in Trillions)



Source: Bloomberg Finance L.P. as of 12/5/2019

The increase in U.S. Treasury debt has been sudden and massive.

The U.S. Federal Reserve Board (the Fed) appeared to help by purchasing $288 billion of U.S. Treasury bonds from the beginning of September to mid-November (**Chart 2**). The Fed pleaded that they were *not* assisting as the purchases were more toward to near-end of the maturity curve unlike most of the bonds that were being auctioned. However, any purchases could help to facilitate things on a net basis. And, many investors perceived it as "help" regardless. Plus, it was the first significant purchase in almost five years.[2]

At the same time, the U.S. Federal Reserve resumed their purchases of Treasury debt.

Another indicator of the unprecedented rapid issuance of U.S. Treasury bonds was the surprising reduction in bank liquidity to the point where the Fed had to step in with overnight loans to make sure many of the banks could maintain their reserve requirements while spending cash to acquire the bonds.[3] [4]

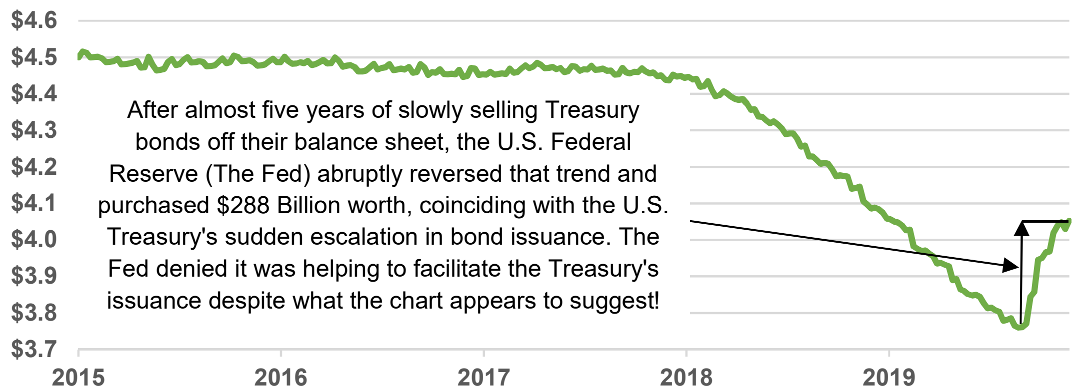
The Fed also assisted banks and dealers with liquidity so that they could also participate in the bond buying.

[2] Source: Bloomberg Finance L.P. - The U.S. Federal Reserve's inventory of purchased U.S. Treasury bonds peaked on January 14, 2015.
[3] There are 24 primary dealers that participate in purchasing bonds directly from the U.S. Treasury. Most of these dealers are owned by banks. They tend to stand ready to purchase Treasury bonds as part of their obligations as primary dealers.
[4] Disclosure: TD Securities (USA) LLC is one of the 24 primary dealers.

Much of the Democrats' affinity with spending appears to be ideological. My assessment of Mr. Trump is that he is one of the *least* ideological people on the current political landscape. So, what's driving his current burst in spending ambitions? It would be impossible to believe that the presidential election coming up in November 2020 is not the primary motivation.

Chart 2:

Total Assets on The U.S. Federal Reserve Balance Sheet (in Trillions)



Source: Bloomberg Finance L.P. as of 12/5/2019

If the presidential election *is* the primary motivation, it might be safe to assume that Mr. Trump will attempt to spend virtually every dollar raised via the issuance of U.S. Treasury bonds by November 3, 2020. Anything spent the following day will be useless for the purposes of campaigning. That doesn't mean that it will all be spent. Often, spending is slowed by other legislation (some projects need Congressional approval), and by the logistics of procurement and project planning. However, if half of this additional cash is spent, it could add about 2.3% to U.S. Gross Domestic Product (also known as GDP or economic output).[5] [6]

It is difficult to separate the potential for increased spending with the notion of electoral politics, which suggests the spending will be focused on the period prior to the November 2020 presidential election.

The last reading of U.S. GDP was 2.1% annualized over the third quarter this year which is also close to the annual growth rate for the 12 months ending September 30th.[7] If we assume that the current factors behind that growth rate remain relatively steady (that's a big assumption I should note), we might see a GDP number that is a percent or two higher depending on the U.S. federal government's success in ramping up spending. And, if someone proclaims to be the pro-growth candidate, that would be one big hammer to

[5] GDP is simply the sum of government, business, and consumer spending. If the government spends more, the accounting used to calculate GDP will add that spending to the nation's economic output.
[6] The calculation of 2.3% was arrived at by dividing $500 billion into the current total dollar amount of U.S. GDP as estimated by the U.S. Bureau of Economic Analysis to be $21.542 Trillion at the end of the third quarter, September 30, 2019.
[7] U.S. Bureau of Economic Analysis.

wield during a campaign. Thus, it would be an extra strong incentive for the incumbent to spend as much of the raised funds as possible.

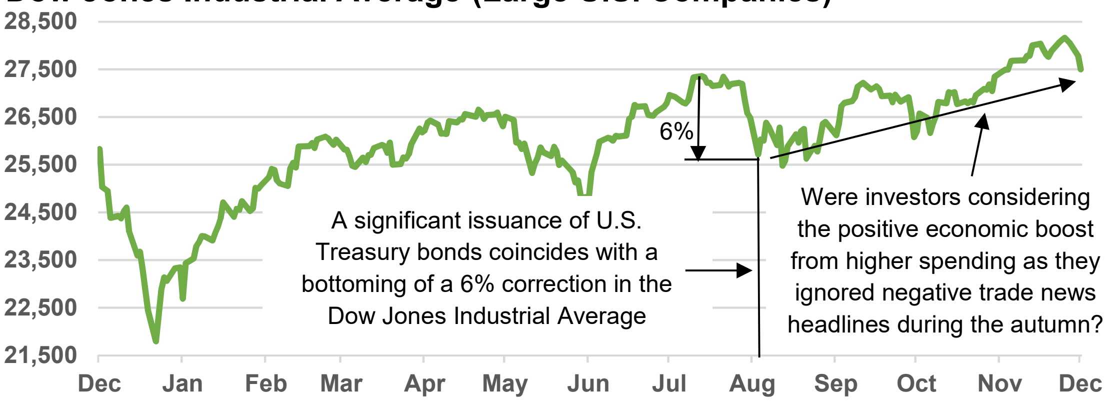
There is some evidence that better economic growth helps the incumbent president.

Research conducted by Larry Bartels of Vanderbilt University between 2007 and 2011 concluded that every additional 1% of GDP growth in the year before a presidential election resulted in a 1% increase in voter support for the incumbent president.[8] In tight elections, an extra percentage point or two can make a decisive difference, especially with the U.S. Electoral College system of vote distribution.

If spending helps the economy, will it also help the stock market?

The big question is: Could this help the stock market in 2020? There have been many academic studies highlighting *the lack of* correlation between economic growth and stock market gains. However, the spending won't hurt with everything else held constant. Perhaps this is what the stock market has been sniffing during its current run-up which appears to be weathering the volatile trade negotiation news rather well (**Chart 3**).

Chart 3:
Dow Jones Industrial Average (Large U.S. Companies)



Source: Bloomberg Finance L.P. as of 12/5/2019

Correlation between economic growth and short-term stock market gains is underwhelming. But, the positive psychology of expecting the spending to help could provide some short-term impetus for the markets.

Also, before the election, market expectations regarding the post-November 2020 era will appear on the investment radar screen. Whether or not there is a change in who occupies the White House, the economic policy directions could be quite different. For example, President Trump will not be able to run for a third term. As a result, he could become much less predictable with respect to spending policies. Markets don't like uncertainty and could experience some volatility as investors attempt to determine the economic path the U.S. might take post-2020. As the election approaches, any stock market benefit from all the additional spending could be challenged by growing uncertainty.

---

[8] "Does the economy affect elections any more?" *The Economist*, November 28, 2019. This appears to be the most recent academic research on this subject.

Model Portfolio Update[9]

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	24.5	None
U.S. Bonds	3.5	None
Alternative Investments:		
Gold	7.5	None
Commodities & Agriculture	2.5	None
Cash	2.0	None

There were no changes to the specific holdings or the targeted overall asset allocation in the model portfolios during November.

The only asset class that provided a drag on the portfolios was gold which declined 2.45% in Canadian dollar terms during the month,[10] driven lower by receding inflation concerns. Otherwise, all the other asset classes were positive contributors.

Most of the octane came from stocks (especially the U.S. equity holdings), continuing with the theme which has driven most of the results since the beginning of the year.

The Canadian dollar held relatively steady during the month confounding bulls who were expecting the continued momentum in consumer spending to translate into a stronger

No changes to the model portfolios during November

All asset classes except for gold did well.

Gold lagged as inflation expectations receded during the month.

Most stocks in developed markets continued their run from previous months.

[9] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 12/5/2019. 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.
[10] Source: Bloomberg Finance L.P. as of 12/5/2019.

currency. Perhaps this is because other traders viewed the current stretch of solid consumer spending as transitory.

The Bank of Canada has given the strong consumer spending trend the benefit of the doubt and has refrained from lowering interest rates, taking a different path from that of many other leading central banks around the world. The debate is beginning to focus on the sustainability of this policy. If the Bank of Canada were to eventually lower rates, the Canadian dollar could be a casualty.

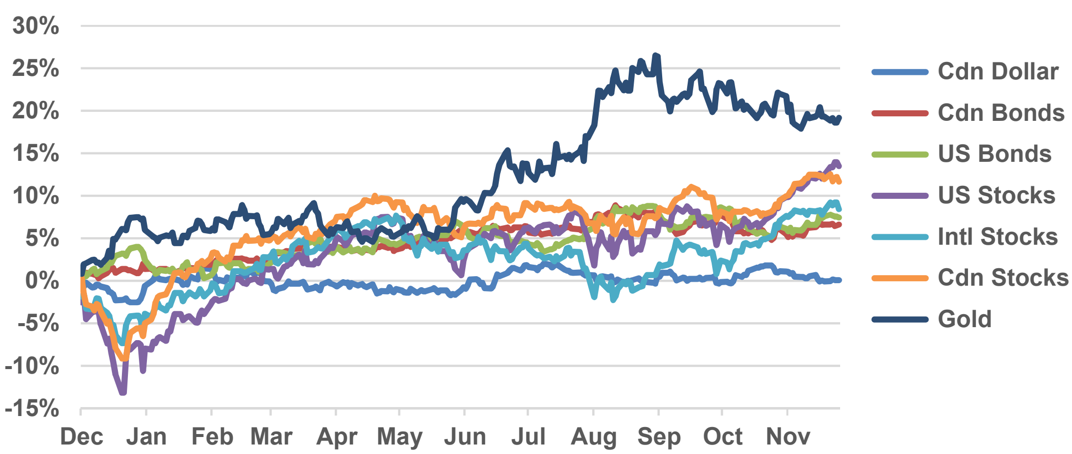
The Bank of Canada held steady on rates despite other countries cutting rates. The debate is whether this is sustainable.

Looking ahead, the challenge will be to assess the stock market impact of the potential cascade of U.S. government spending as discussed in the first section of this *Monthly Letter*. This might be analogous to a game of musical chairs where the markets continue to advance but then enough investors start to fret about post-election uncertainly and scramble for a place to sit before volatility becomes potentially worrisome.

Attention heading into the New Year will focus upon gauging the momentum of recent stock market gains in the face of looming U.S. election uncertainty.

Below is the 12-month performance of the asset classes that we have used in the construction of The Charter Group's model portfolios. (**Chart 4**).[11]

Chart 4:
12-Month Performance of the Asset Classes (in Canadian dollars)



Source: Bloomberg Finance L.P. from 12/1/2018 to 11/30/2019

[11] 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); US bonds are represented by the iShares Core US 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[12]

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

[12] 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
Kelsey Sjoberg | Client Service Associate

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

The Charter Group 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 December 5, 2019.

The Charter Group is part of TD Wealth Private Investment Advice, a division of TD Waterhouse Canada Inc. which is a subsidiary of The Toronto-Dominion Bank.

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.