TD Wealth

The Charter Group Monthly Letter

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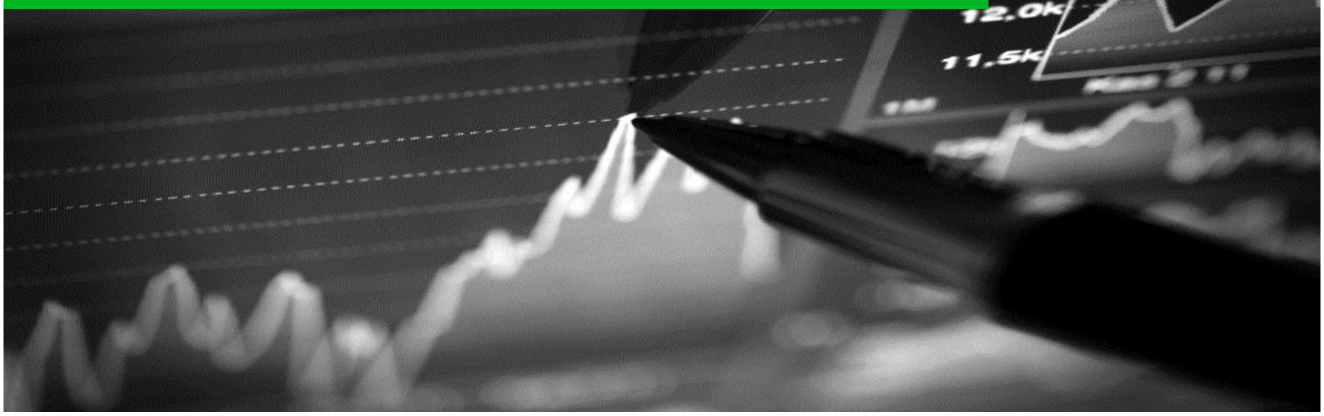

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Economic & Market Update

Coronavirusnomics

Global pandemics make for dramatic headlines which have the potential to impact our emotions, intensifying some of the negative aspects of crowd psychology. With the current coverage of the Coronavirus emanating out of the People's Republic of China, many of us are reminded of past global outbreaks including SARS and the Spanish flu of 1918.

It was the Spanish flu that set the modern highwater mark for global pandemics. One-third of the world's population was infected and over 3% of the population died from it.[1] However, this was an era with completely different sanitation standards (New York City

The Coronavirus has the potential to heighten some negative aspects of crowd psychology.

But, *how* this crowd psychology affects investment markets is not straight-forward.

[1] Centers for Disease Control and Prevention, U.S. Department of Health & Human Services, March 2019.

was still plagued by towering piles of manure as horse-drawn transportation had not been totally phased out yet). Also, it was not until *after* the pandemic had passed that scientists were finally able to conclude that it was a virus that was the culprit. During the spread, bacteria was incorrectly suspected.[2] Yet, despite this disease apocalypse, the U.S. market was higher over the period (**Chart 1**)!

We have learned from previous pandemics.

Chart 1:

Dow Jones Industrial Average: During the Spanish Flu 1918-1919

Source: Bloomberg Finance L.P. as of 2/7/2020

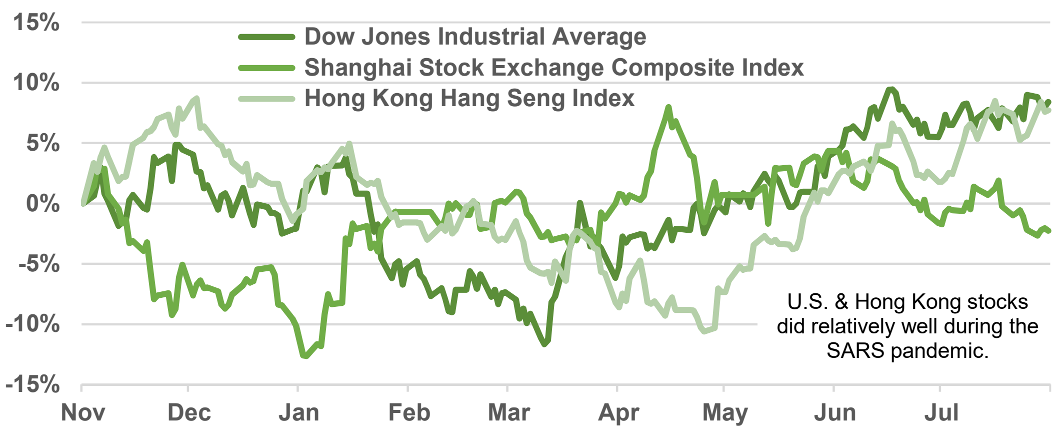
More effective containment has been the feature for pandemics post-1918. Detection, isolation, sanitation, instant communication, and vaccines have played important roles in containing new and unknown viruses. So, should investors worry about the current Coronavirus given that the world has never been better equipped to handle it?

Improvements in detection, isolation, sanitation, communication, and vaccination have helped containment.

At the date of this writing, the answer is: Maybe.

Chart 2:

Markets During SARS Epidemic 2002-2003



Source: Bloomberg Finance L.P. as of 2/7/2020

[2] "Spanish flu: The Virus That Changed The World", *BBC History Magazine*, January 2020.

Investors are still waiting for clarity on the rate of transmission. Skepticism is probably prudent given the reluctance China to be transparent during the first few months of the SARS outbreak. Preliminary mathematical modelling performed by the London School of Hygiene & Tropical Medicine estimates that the number of inflections in Wuhan might peak at 500,000 by late February, more than ten times the current tally.[3]

Investors are waiting for more clarity on rate of transmission before they can fully assess the risks.

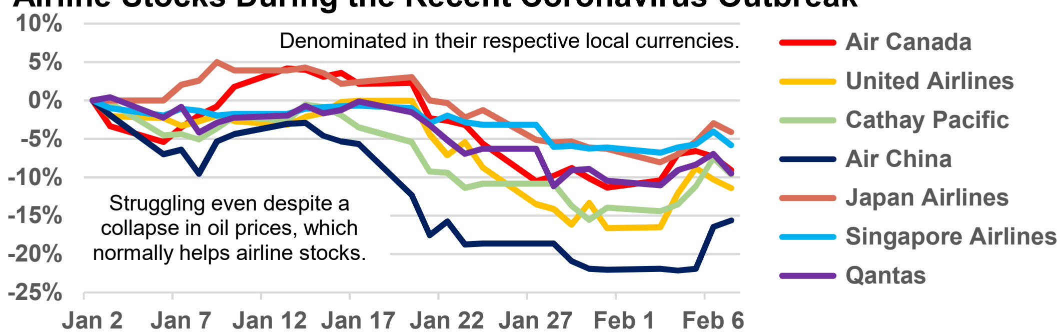
Chart 3:

Markets During the Recent Coronavirus Outbreak

Source: Bloomberg Finance L.P. as of 2/7/2020

Chart 4:

Airline Stocks During the Recent Coronavirus Outbreak



Source: Bloomberg Finance L.P. as of 2/7/2020

Physically, we can take precautions that would make contraction statistically miniscule. However, *financially*, any investment portfolio containing risk assets like stocks (including The Charter Group's model portfolios), might have to deal with some pandemic-related uncertainty.

Increased rates of infection in manufacturing regions could concern investors.

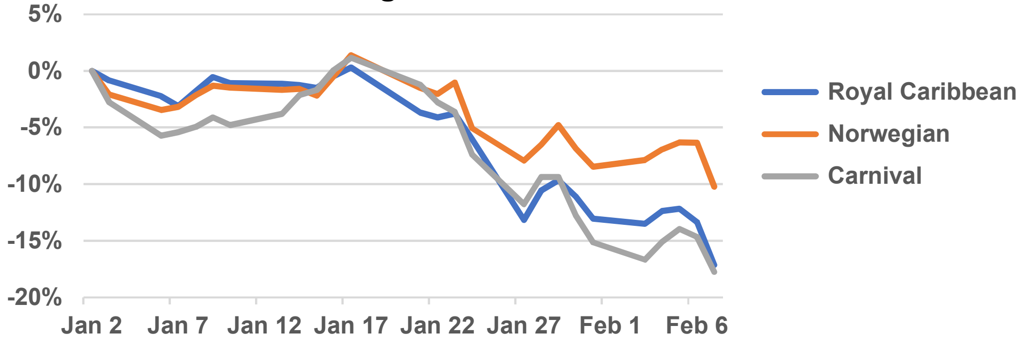
However, investors might be more concerned about specific sectors.

Markets could face volatility if negative crowd psychology gets impacted by any news of higher-than-expected rates of transmission in areas of the world that have a manufacturing focus. Generally, this could impact global economic growth which depends

[3] "Coronavirus May Soon Peak in Wuhan With 500,000 People Infected." Bloomberg News, February 10, 2020.

heavily upon a finely-tuned supply chain. For example, if people can't get to work to assemble iPhones, then there would be fewer iPhones available to sell.

Chart 5:
Cruise Line Stocks During the Recent Coronavirus Outbreak



Source: Bloomberg Finance L.P. as of 2/7/2020

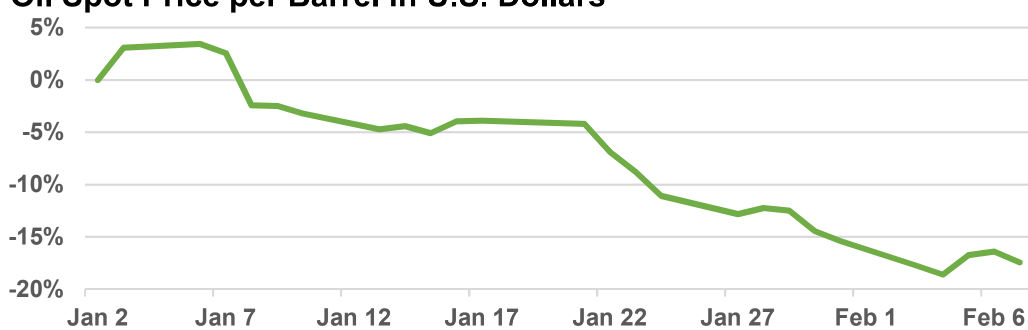
That said, it is probably more important to assess sectors that are especially vulnerable. The travel industry has already seen significant cancellations. Airlines have cancelled many Asian routes until further notice. Airline employees have been forced to take unpaid leave. Some Asian hotels and casinos are almost empty. And stories about being quarantined on cruise ships can't be expected to help future bookings. All this has contributed to travel stocks getting hammered (**Charts 4&5**).

The travel & hospitality sectors may be the most vulnerable.

The energy sector is also exposed to risks. At the margin, oil prices tend to teeter on global supply and demand. If the demand part of the equation looks to be dampened for a while, it will be difficult for the price of crude to lift (**Chart 6**).

The energy sector could be hurt by lower oil prices resulting from less global demand for crude.

Chart 6:
Oil Spot Price per Barrel in U.S. Dollars



Source: Bloomberg Finance L.P. as of 2/7/2020

History suggests that pandemics have a subdued impact on markets overall. If previous trends are repeated and volatility is mainly limited to specific sectors and geographies, then investors may have to look elsewhere for things to worry about.

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

No alterations were made to the model portfolios in January.

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

Gold and bonds were the main contributors to return during the month.

Except for international stocks, which were down almost 1% during the month, all the other asset classes were positive contributors. Gold was up almost 6% in Canadian dollar terms and bond prices were significantly higher due to falling interest rates resulting from the concern over the Coronavirus.

The Loonie weakened as investors bought U.S. dollars for safety. This helped the U.S. stocks in the portfolio.

We also saw some weakening in the Loonie as some the prospect for a policy rate cut in Canada sometime over 2020 became more probable versus a cut in the U.S. as worries regarding the sustainability of Canadian consumer spending mounted. Currency traders were also gravitating to the U.S. dollar as a safe-haven until the fallout from the Coronavirus is better understood.

[4] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 2/7/2020. The asset allocations of individual clients invested in this Portfolio may 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.

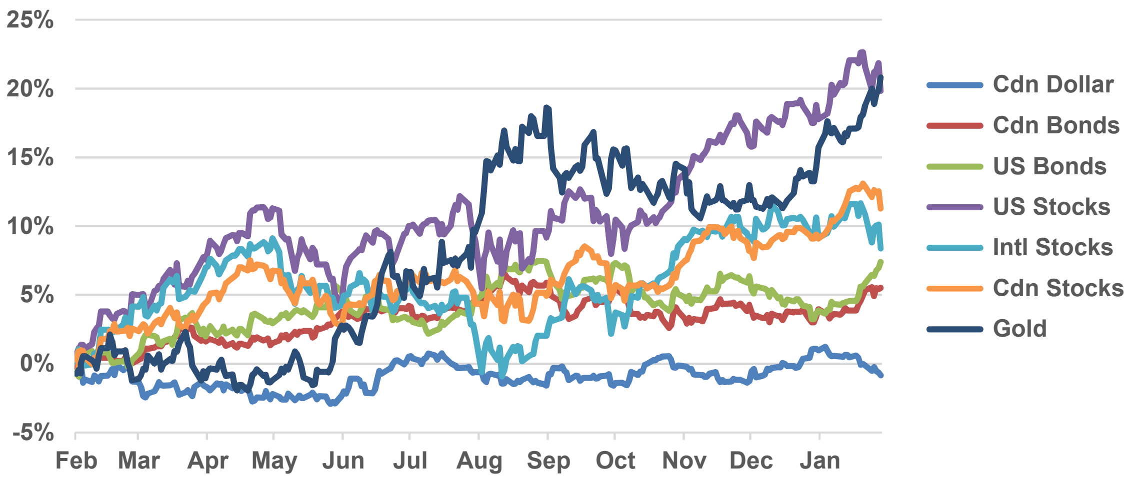
U.S. government spending and low interest rates could help to cushion the markets from much of the negative news regarding the Coronavirus.

Between now and the U.S. presidential election on November 3rd, we believe that the investment landscape will continue to be positively influenced by the prospect of massive U.S. federal government spending, and by the notion that U.S. interest rates will remain low to help finance that spending.

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 7**).[5]

Chart 7:

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



Source: Bloomberg Finance L.P. from 2/1/2019 to 1/31/2020

[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); 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[6]

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

[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 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 February 10, 2020.

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.

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