TD Wealth

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Economic & Market Update

Coronavirus: Canada's Economic Plan C

C is for Consumer.

As I have written about numerous times, I believe that Canada has an informal economic Plan A. Regardless of which political party has had federal power, Plan A has been to rely upon our surplus of resources. We are naturally endowed with all sorts of materials, such as lumber and minerals, as well as significant reserves of energy. While resource extraction requires capital, it's pretty simple. The U.S., where resources account for a much smaller portion of economic output, is forced to diversity their industries to a greater extent. And, many of those industries require sizable investments which may not pay off. However, that risk-taking does provide a number of successes.

Canada's informal economic plans:

Plan A = Resources

Plan B = Real Estate

Plan C = Consumers

The risk is when we run out of plans upon which we relied.

However, as the commodity boom, which was driven primarily by demand from the People's Republic of China, faded around 2012, Plan A went into hibernation. Fortunately, an informal Plan B emerged just in time: real estate. Low mortgage rates and high consumer confidence helped to counter the contraction in the resource sectors. Also, at the margin, much of the real estate was being purchased for reasons other than primary or recreational residences. Buyers saw value in merely storing wealth, or in taking out mortgages on multiple properties and then listing them as short-term rentals online, propelling real estate growth beyond the overall rate of national economic growth.

Plan A is what the Canadian economy historically relies upon as it is relatively simple to extract and export resources.

Much of the "non-primary residential" activity turned real estate into a significant political issue, inducing governments to conduct micro-management aimed at limiting the price increases. This caused many economists to question Canada's economic growth because of the recent reliance on real estate. However, consumer spending continued to surprise to the upside regardless. Adding to the mystery was that Canada's per capita productivity had stagnated whereas U.S. productivity continued to rise.

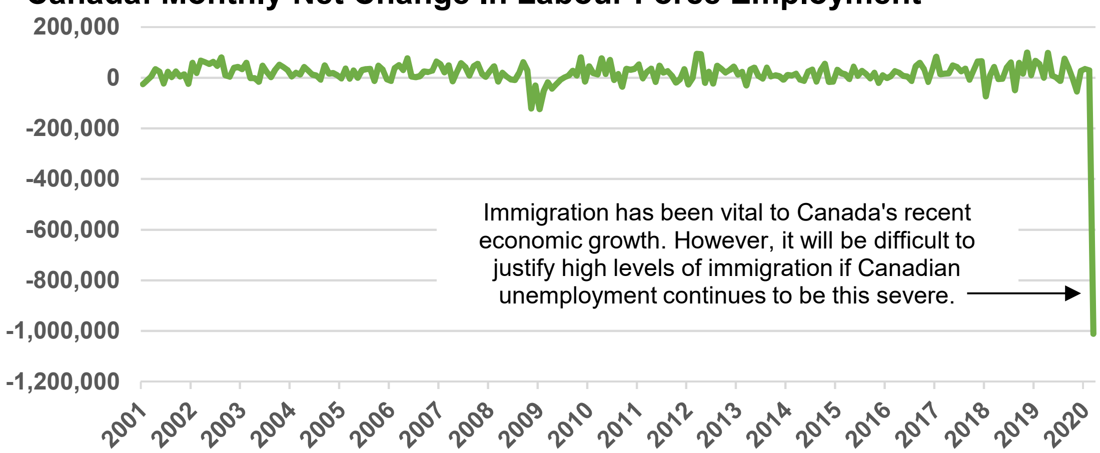
Plan B thrives with low mortgage rates, high consumer confidence, and inflows of foreign capital looking for a safe-haven.

Then, beginning last summer, a consensus among economists emerged, connecting the resiliency in consumer spending to increasing immigration flow into Canada. Economic growth driven by immigration tends to be front-end loaded. Significantly outlays related to shelter, clothing, and other costs of establishing a new life occur early on. However, if the flow is continual, then the positive economic effect tends to be continual as well.

Plan C thrives with very low unemployment and a steady flow of immigration.

On March 12, before the Coronavirus lockdowns, the federal government announced an increase in immigration over the next three years, 341,000 in 2020, 351,000 in 2021, and

Chart 1:
Canada: Monthly Net Change In Labour Force Employment



Source: Bloomberg Finance L.P. and Statistics Canada as of 4/15/2020

361,000 in 2022.[1] Perhaps, this was an outline of a Plan C taking shape. Those numbers could have helped maintain or even increased consumer spending over that time period, during which there was already worries about global economic growth slowing down.

Reliance on Plan A was impacted by the end of the commodity boom.

At the March 12 announcement, it was highlighted that Canada was facing a labour shortage. Obviously, that is not the case anymore with Canada losing over one million jobs by the end of the month (**Chart 1**).

Reliance on Plan B started to waver when measures to contain rising real estate prices were enacted.

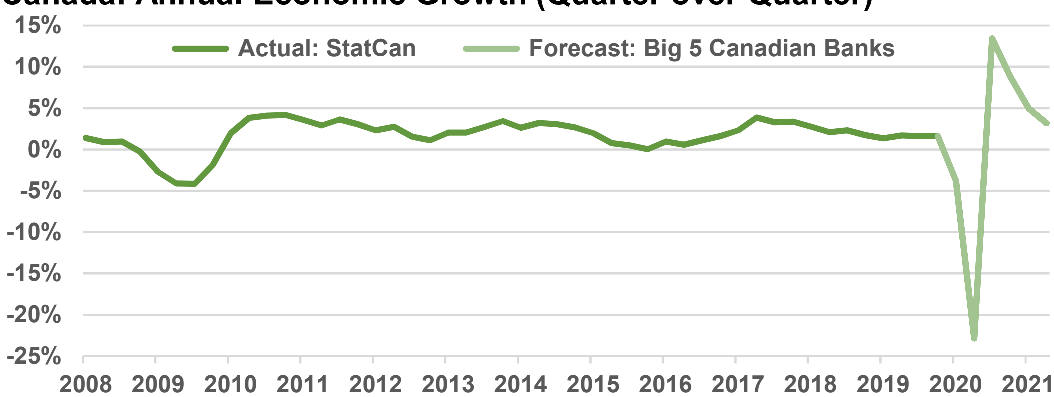
Obviously, the federal immigration targets for 2020, and perhaps beyond, are in severe jeopardy. Travel restrictions complicate the logistics of federal officials processing claims overseas and the logistics of physically transporting people into Canada. Additionally, there might be some pushback from the millions of newly unemployed Canadian citizens and permanent residents who would be competing for work with the people arriving.

Plan C is now at risk because of an historical spike in unemployment as a result of the Coronavirus-related lockdowns.

The increase in unemployment could also severely limit immigration, something else that was also helping to boost Plan C.

Chart 2:

Canada: Annual Economic Growth (Quarter over Quarter)



Source: Bloomberg Finance L.P. and Statistics Canada as of 4/15/2020, and Jason Kirby, "Coronavirus plunges Canada's economy into the abyss," April 6, 2020. *Maclean's Magazine*. The Canadian forecast is an average of the published forecasts from BMO, Scotiabank, TD, CIBC, and RBC as of April 6.

So, what is the solution for this uniquely Canadian economic dilemma? A quick resolution to the economic lockdown would help to restart immigration flows. However, there is clearly a public health problem if lockdowns are hastily lifted. This last week, the Prime Minister suggested that the "new normal" could extend for a significant period of time.

One glimmer of hope would be if there was a rush to buy resources once the global economy begins to find its footing again. Materials and energy could see a spike. If that does happen, it probably would *not* be prudent to assume that the economic Plan A is

[1] Kait Bolongara and Shelly Hagan, "Faced With Crisis, Trudeau Forced to Shift on Immigration," April 8, 2020. Bloomberg News.

coming back to save us. Global conditions are very different than they were during the commodity boom that fizzled in 2012. Instead, we could see a flattening of demand after the initial global demand for resources is satiated.

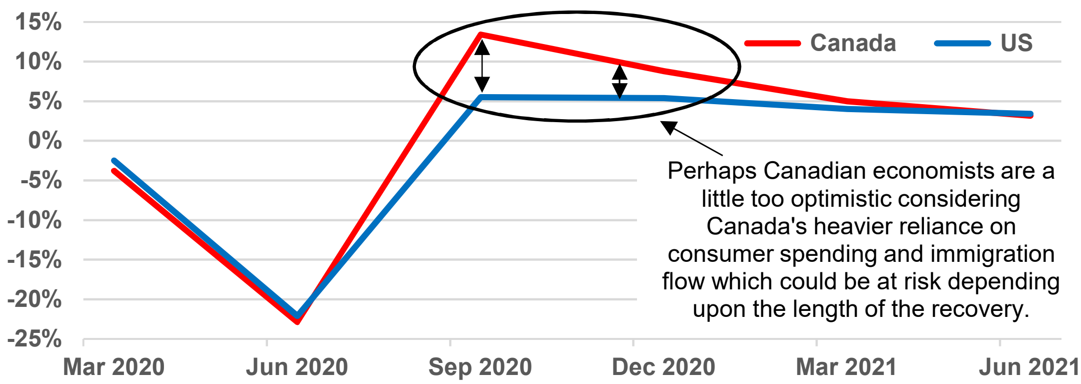
With respect to economic Plan B, it might be a stretch to imagine a reigniting of the real estate boom considering the current circumstances. Plus, Plan C (consumer spending driven by consumer confidence and immigration) sort of fed into Plan B.

It is times like this where it is hard not to be envious of the broader economic diversification of the U.S. economy. That appears to be a better situation when contemplating various recovery scenarios. Even if a few sectors contract because of the new economic realities, there is always the possibility that other sectors will find greater opportunities in the post-Coronavirus world. In Canada, if immigration numbers are not able to bounce back, then we may be out in the wilderness for a while hoping for some sort of Plan D to come along!

The risk of all the informal economic Plans struggling in the post-Coronavirus world reveals the risk of not having a broadly-diversified economy like the U.S.

Chart 3:

Forecasted Canadian & U.S. Economic Growth (Quarter over Quarter) Annual Growth For the Quarter Ending in the Month Indicated



Source: Bloomberg Finance L.P. and Statistics Canada as of 4/15/2020, and Jason Kirby, "Coronavirus plunges Canada's economy into the abyss," April 6, 2020. *Maclean's Magazine*. The Canadian forecast is an average of the published forecasts from BMO, Scotiabank, TD, CIBC, and RBC as of April 6. The U.S. forecast is an average of 69 economics surveyed by Bloomberg News between April 3 and April 9.

Apart from issues like economic diversification and economic plans, government attempts at stimulating activity and bailing out sectors and companies will likely factor heavily over the next year or so. At this point, those are very challenging to gauge and would likely need another issue of *The Charter Group Monthly Letter* to properly assess. However, it seems unlikely that some combination of government assistance could offset Canada's growing economic dependence on immigration despite some of the recent forecasts that appear to be a little too rosy when compared against U.S. forecasts (**Chart 3**).

Canadian economic forecasters may be a little too optimistic with respect to Canada's recovery compared to the U.S.

Model Portfolio Update[2]

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

	Target Allocation %	Change
Equities:		
Canadian Equities	13.0	None
U.S. Equities	38.0	None
International Equities	8.0	None
Fixed Income:		
Canadian Bonds	24.5	None
U.S. Bonds	3.5	None
Alternative Investments:		
Gold	8.0	None
Commodities & Agriculture	3.0	None
Cash	2.0	None

There were no changes to the specific holdings or the targeted overall asset allocation in the model portfolios since the last edition of the *Monthly Letter* was published at the beginning of this month.

No changes were made to the model portfolios during the first half of April.

In response to early signs that Coronavirus infection rates in some of the hotspot areas was beginning to level off a little earlier than expected, stock markets have been bounding higher. Much of this enthusiasm might be related to a reduction in the amount of uncertainty going forward. Infection and morbidity numbers are still exhibiting inertia, so there is a risk that some of these price gains may be given back. However, the psychological state of the markets looks improved compared to a month ago.

Stocks shot upwards as Coronavirus infection rates showed signs of levelling off. But there is a risk that some of the gains could be given back if the news changes.

U.S. stocks were the top performing equity asset class over the first two weeks of the month (+9.53%), followed by Canada (+6.59%) and then international stocks (3.04%).[3]

[2] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 3/31/2020. 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.
[3] Source: Bloomberg Finance L.P. as of 4/15/2020. Using the Dow Jones Industrial Average for U.S. stocks, the S&P/TSC Composite Index for Canadian stocks, and the MSCI EAFE Index for international stocks.

There was also some stabilization in North American bond markets as the U.S. Federal Reserve and the Bank of Canada announced that they would be buyers of corporate bonds, something they have not done before. In March, some of parts of the bond market lacked liquidity resulting from selling associated with margin calls and the fact that bond traders, who trade mostly between themselves as opposed to trading on a listed exchange, had to work from home.

Some stabilization in certain areas of the bond markets that were subjected to liquidity concerns before central banks stepped in.

Going forward, it is worth noting that governments and central banks are throwing every tool they can at the economic problems caused but the Coronavirus. I believe that is a net positive. However, it is still too early to isolate the specific impacts but it is probably enough to provide a general Band-Aid solution. The critical stage will be when the policymakers need to scale back or withdraw the aid as the recovery unfolds. That could become very political and could affect which sectors and companies do well and which don't. It would be at that time when we might make some significant changes to our model portfolios.

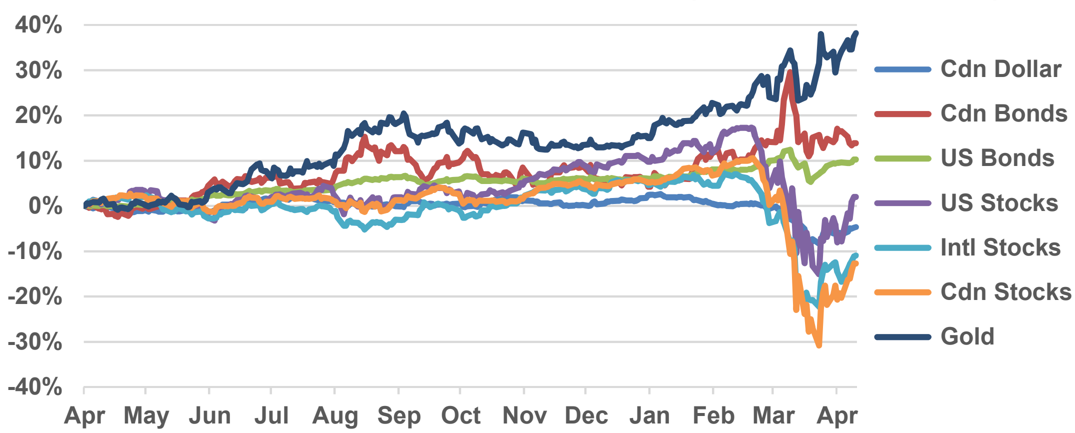
Stimulus and bailouts, in addition to the already high level of government spending in Canada and the U.S., can hopefully provide a Band-Aid solution.

But all that aid could produce some hangover effects as things recover.

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**).[4]

Chart 4:

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



Source: Bloomberg Finance L.P. from 4/1/2019 to 4/15/2020

[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 current 3-year Government of Canada Bond; US bonds are represented by Barclays US Aggregate Bond Index; U.S. stocks are represented by the S&P 500 Index; International stocks are represented by the MSCI EAFE Index; Canadian stocks are represented by the S&P/TSX 60 Composite Index; Gold is represented by the Gold to US Dollar spot price.

Top Investment Issues[5]

Issue	Importance	Potential Impact
1. U.S. Fiscal Spending Stimulus	Significant	Positive
2. Coronavirus Geopolitics	Significant	Negative
3. Canadian Dollar Decline	Moderate	Positive
4. Canadian Federal Economic Policy	Moderate	Negative
5. China's Economic Growth	Moderate	Negative
6. Short-term U.S. Interest Rates	Moderate	Positive
7. Canada's Economic Growth (Oil)	Moderate	Negative
8. Deglobalization	Medium	Negative
9. Global Trade Wars	Medium	Negative
10. Long-term U.S. Interest Rates	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.

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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 April 15, 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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