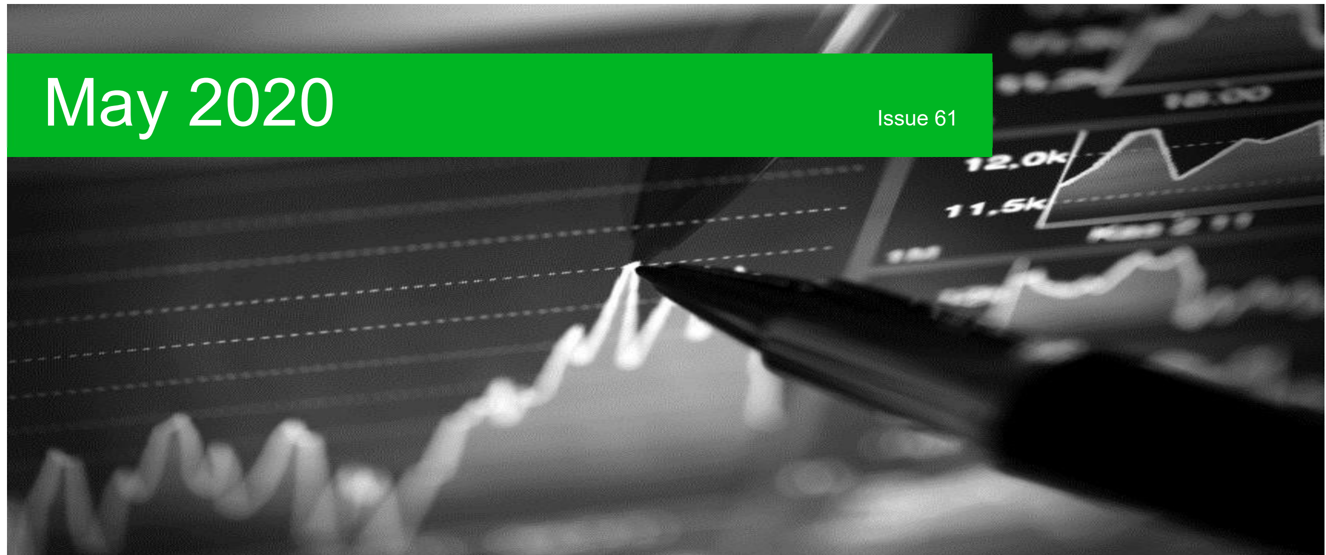
TD Wealth

The Charter Group Monthly Letter



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Economic & Market Update

Thoughts on the Post-Coronavirus World – Volume 1

The Coronavirus has been roiling the investments markets for two months now. Massive volatility as a result of economic uncertainty has given way to markets that are now trading in tighter ranges as investors start looking ahead. Although there is some risk of headlines catching the markets by surprise and testing the March lows, those headlines would have to be pretty astonishing at this point. But, it appears that the probability of those scenarios is declining as more time passes. However, as investors gauge the post-Coronavirus world, I would not be shocked to witness seesawing volatility as alternating good news and bad news gets digested. The following pages list some of my thoughts regarding that post-Coronavirus world.

V-shaped Recovery

Economists like to assign “shapes” to economic recoveries. One is the V-shaped, which is fairly self-explanatory. This is the most desirable but would probably also be the most unlikely because the magnitude of the current economic decline will probably take longer to reverse. Plus, the V-shaped implies symmetry, where the recovery mirrors the initial decline. It would be hard to imagine the economy re-opening as fast as it was locked down. The V-shaped would have the least impact on the investment markets relative to other recovery shapes. Looking back, things might look like a mere blip in financial market volatilty. But, don’t put too much hope in this scenario.

U-shaped Recovery

The U-shaped recovery is where the economy needs more time to heal, perhaps with the help of government policies which would likely take some time to get implemented and to achieve the desired effect. Not as desirable as a V-shaped as it would entail longer periods of unemployment and stagnating corporate profits which could impact stock prices. And, just like the V-shaped, the U-shaped also implies an economy reopening the same way it closed down. Not very likely. The U-Shaped is a little more probable than the V-shaped, but would be a net negative for stocks overall as it would imply more time lost with respect to economic production and corporate profits.

Hockey Stick-shaped Recovery

This shape has a little more credibility. The blade of the stick represents the decline, and the long handle represents the recovery. This expectation extends the time of recovery because of the disruptive effects of the initial decline or because of other concurrent issues. Back in the late 1980’s, Canada was subject to a Hockey Stick-shaped recovery from a recession as we had to deal with lower prices for our exported commodities as well as a constitutional crisis while trying to reignite the economy. The U.S., which saw a recession at about the same time, had a U-shaped recovery, recovering the lost economic output in half the time compared to Canada. The Hockey Stick would be relatively more painful for stocks than either the V- or U-shaped because of the prolonged slump.

Staircase Recovery

The Staircase illustrates a recovery characterized by attaining a new level and then plateauing off for a period of time until new economic factors drive things to the next level.

We might see this if there is a clearly-defined staggered reopening of the economy. Certain industries may be deemed safer than others health-wise, and may be allowed to open earlier. The riskier industries may even open earlier than expected, but consumers may not feel safe enough to patronize them like they did in the past until they are confident of the new measures in place. This shape of recovery may be the most probable, but the stairs may be more rounded than hard-edged. The overall impact on stocks may be similar to the Hockey Stick-shaped recovery but with a little more volatility.

Two-steps-forward, One-step-back Recovery

This shape accounts for the possibility that there will be setbacks along the way. I think there will be stumbling blocks, but their economic impact might be limited unless the news is very surprising. One risk is the possibility of a second-wave. But, the second-wave scenario is widely discussed in the media, so it would not be that shocking to investors. Plus, current measures and protocols are in place to minimize the size of a second wave so that if it does emerge it may not be the showstopper that doomsayers anticipate. As a result, I don't deem it as probable as the Staircase-shaped, which might be a good thing as it would likely be the worst scenario for stocks by lengthening any economic doldrums.

The Viral Curtain

This is something that might contribute to a Staircase recovery. How likely would it be to have a uniform lifting of travel restrictions? Will it be as easy to travel to Montreal or Los Angeles as it is to Tehran or Wuhan? We could see a situation where places with less transparency with respect to the Coronavirus are blocked from travel until everyone is vaccinated. Will all countries allow health inspectors from other countries to enter and evaluate things on the ground? As we saw with the initial outbreak, that is not how things work in much of the world. As a result, we could see a "Viral Wall" that slowly extends outward from Canada as we become more confident that things have been contained elsewhere. Each progressive step outward might equate to a step on the Staircase-shaped recovery as the mobility of people and commerce hopefully increases in stages.

De-globalization

The economic miracle of cheap goods has been facilitated by globalization where countries focus on producing what they are the best at and then import whatever else they might need. Although globalization has been around for centuries, it has grown

dramatically since the end of the Cold War three decades ago. However, we may now be entering a phase where some amount of de-globalization unfolds. Countries may not be confident if sizable supply chains extend to regions with higher pathogen origin risks (because of local customs or local sanitation standards). We are already seeing debate surrounding the production of vital equipment and pharmaceuticals where the benefits of lower offshore costs could be outweighed by national security and public health concerns.

Vital medicine and equipment are rather mundane topics to most. But in the scenario where we would be paying $2,000 for an iPhone because it had to be manufactured in a developed country with higher labour costs, it might be a different story!

An acceleration in de-globalization by repatriating manufacturing would likely stretch things out and support the notion of a Hockey Stick- or Staircase-shaped recovery. Overall, wouldn't be great for stocks.

Fool Me Thrice

The old "Fool me twice" adage might apply to the risks of maintaining a global supply chain into riskier regions if another pathogen emerges again in the next couple of years. However, what we are seeing now with respect to how the Coronavirus emerged and the alleged mishandling of the initial outbreak appear similar to what happened with the SARS outbreak in 2002-03. So, to a certain extent, the risks were known, but globalization continued essentially unabated. Perhaps 17 years was enough time to provide a degree of separation and thereby lead to reduced precautions (SARS was less transmissible but much more lethal per infection as we saw in Ontario). But, here we are again. Getting caught a third time while not managing the pace and nature of globalization could have severe political and career costs for today's politicians and corporate leaders. Whether we have been burned once or twice before, an increasing aversion to embracing global supply chains could increase the costs of production and reduce corporate profits.

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The above musings are generalities. Although there is not much good news for stocks compared to if the Coronavirus never appeared, there will almost certainly be sectors and firms that will emerge as the new champions of the post-Coronavirus world. I'll continue with more of these thoughts in the next edition of *The Monthly Letter*, adding a little more detail with respect to potential impact on different asset classes and industrial sectors.

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Model Portfolio Update[1]

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

No changes were made to the asset class weightings or to the specific securities in the model portfolios during April.

No changes made to the model portfolios during April.

Many financial media commentators were eager to point out the significant increases in various stock market indices during April. However, this seems to ignore the low base from which we sprang in March. The results, while very welcomed, are more statistical curiosities than a robust advances driven by company fundamentals in my opinion.

All asset classes rose over the month.

Stocks rose significantly.

However, it is important to note that we started from a relatively low base at the beginning of the month.

All the asset classes that we use in the construction of the model portfolios where higher for the month. The Dow Jones Industrial Average (large U.S. stocks) and the S&P/TSX Composite Index (Canadian stocks) were both up over 10% during April.[2] Gold was the next best contributor, up almost 7% in Canadian dollar terms.[3] Even bond prices

[1] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 5/1/2020. 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.
[2] Source: Bloomberg Finance L.P. as of 5/5/2020.
[3] Source: Bloomberg Finance L.P. as of 5/5/2020.

continued to improve some in April as actions taken by the Bank of Canada and the U.S. Federal Reserve helped maintain sufficient liquidity which was a concern back in March.

The Canadian dollar strengthened slightly which was surprising because of the challenges Canada might face when financing the bailouts and handouts.

I was a little surprised by the slight uptick in the value of the Canadian dollar versus the U.S. dollar. The Canadian dollar could encounter some headwinds if currency traders conclude that Canada may have a tougher time financing all the handouts and bailouts compared to the U.S. In my view, the U.S. dollar is a true functioning global reserve currency, offering much more leeway in financing deficits. Plus, the American economy has a greater array of high-value added industrial sectors which could help to increase tax revenues when economic activity recovers, reducing the reliance on borrowing.

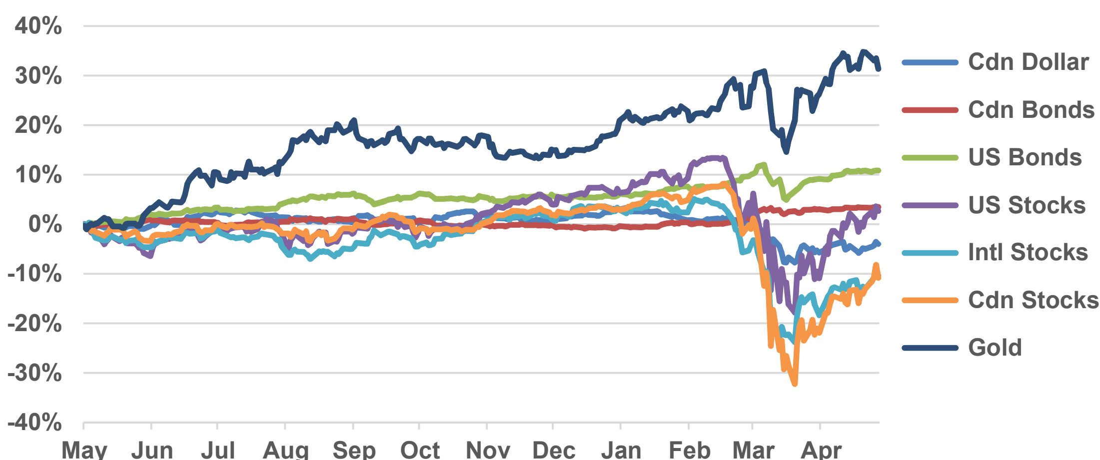
Rampant money-printing and government spending have the potential to offset much of the market impact from downward revisions of corporate earnings and economic growth

In the meantime, the unprecedented torrent of stimulus might put a floor under the market which could be needed to counter future downward corporate earnings revisions and other unanticipated negative economic news. That said, it is hard to imagine any leaders espousing austerity at the current time. It would be reasonable to expect central banks to keep printing money until they can't. But, I still think those forces that would cause them to limit money creation, such as a debt crisis or inflation, are a little over the horizon.

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 1**).[4]

Chart 1:

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



Source: Bloomberg Finance L.P. from 5/1/2019 to 4/30/2020

[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. De-globalization	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 May 5, 2020.

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.

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