TD Wealth

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Economic & Market Update

Ante Up

The stock market has made an impressive comeback from the lows that were set in late March. However, weren't we supposed to be heading towards another Great Depression? Isn't there supposed to be elevated unemployment for the foreseeable future? What's happening?

Why is the stock market higher when there still appears to be so much gloom regarding the Coronavirus?

Those questions would be perfectly understandable if the stock market was some kind of "economic speedometer". But, it's not.

Instead, the stock market tends to behave like a barometer of what the economic weather will be out to the forecastable time horizon. The aggregate of all investors' sentiments is inherent in the current level of a stock market index. And, even though there might be debate about how long into the future a person can reasonable forecast the economy and corporate conditions, the index will tend to capture the average of beliefs with respect to how far out that horizon is. My belief is that it tends to be about seven years out based on historical stock market cycles.

The stock market tends to look out a number of years into the future and will weigh that against the current news.

My view is that if the bulk of investors have relatively firm convictions of where the economy and companies will be over the next seven years, this will have a very significant impact on *current* stock index levels. At the margin, short-term speculators may have also added fuel to the recent rally, but it is unlikely that they could have produced a rally across most global markets without the significant participation of longer-term investors.

Some short-term speculation has also added to the rally.

The current market action (**Charts 1&2**) may be an example of investors looking past most of the current headlines and trying to imagine what a post-Coronavirus world may look in terms of economic growth, employment, emerging and declining sectors and companies, debt burdens, and expected government interest rate policies.

Chart 1:

Dow Jones Industrial Average (US Stocks): Year-to-Date

Souce: Bloomberg Finance L.P. as of 6/17/2020

Chart 2:

S&P/TSX Composite Index (Canadian Stocks): Year-to-Date

Souce: Bloomberg Finance L.P. as of 6/17/2020

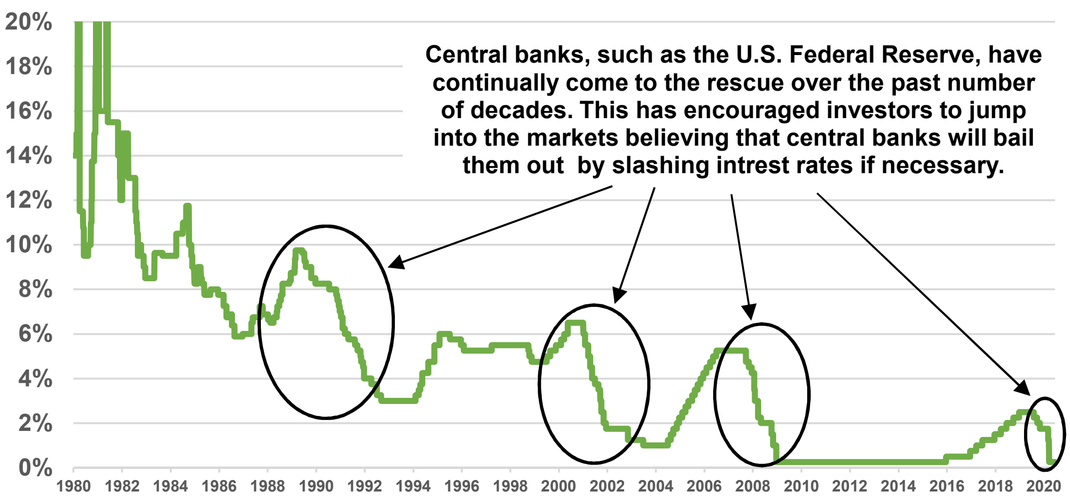
Another phenomenon that has become prevalent in investor behaviour is the fear of missing out (increasingly known by its acronym, FOMO). When I was a college student in the 1980s, it was the previous few decades of market patterns that composed much of the study material. In the 1970s, there wasn't much FOMO. Instead, investors would remain on the sidelines during many of the market advances. In that era, central banks like the U.S. Federal Reserve Board and the Bank of Canada were not keen to come in and support asset prices by easing up on monetary policy. That could have risked adding to the inflation fires that were raging during that decade. Therefore, many market advances would fade away with minimal investor participation.

The modern investor is much more confident to invest early after a correction and drive a rally because of the perceived backstop provided by central banks.

Over the least four decades, central banks have been much more willing to come to the rescue as inflation concerns dwindled (**Chart 3**). This may help explain why, once a stock market advance establishes itself now, investors are willing to pile in, sensing that central banks will provide a backstop if the markets begin to crash.

Chart 3:

U.S. Federal Reserve Board: Federal Funds Target Rate



Souce: Bloomberg Finance L.P. as of 6/17/2020

That brings us to the recent rally from the lows of this March. As the level of uncertainty began to recede, enough investors sensed a possible foundation was building that would be able to support an advance. The news was still bad, but not as bad as expected. Plus, after a couple of weeks, some good news was sprinkled in with respect to the pace of a possible economic recovery. Then investors began to jump in. The U.S. Federal Reserve was emphatic that it would do whatever it took to ensure that there would be ample liquidity available to support stocks, bonds, and the economy.[1]

The market activity over the last few months may be analogous to an "ante" at the beginning of a poker game. In order to play, participants are forced to "ante up" before the cards are dealt. Then, as cards are dealt, players can assess their probability of winning. Some players will fold to limit their losses (forfeiting the ante). Some will stay in the game if the probability of winning looks reasonable. And some might even increase their stakes if things move in their favour.

Modern investor behaviour may be similar to a poker game mentality where players are willing to "ante up" in order to participate.

Once the initial wager is made, players assess their chances as more cards are dealt.

Similarly, investors were hopeful enough to sit down at the investing table in late March and early April and invest their capital not really knowing how the Coronavirus pandemic would eventually play out in terms of infection rates and economic impact.

We still don't really know how the pandemic will play out. However, we are starting to get an idea as more data becomes available with respect to transmissibility and containment of the Coronavirus. This provides a glimmer of light with respect to changes in consumer and corporate behaviours and the potential implications for companies, sectors, and the economy. Some investors may start "folding" on stocks of companies that appear to be ill-suited for the post-Coronavirus world, and others may start "raising" if they feel that some of the companies they hold will thrive.

Likewise, investors may assess their chances as more virus and economic data is revealed and buy more or sellout as a result. This could produce volatility.

A note of caution: it is still early days and some of the companies that looked poised to benefit from the changes in consumer and corporate behaviours no longer look as appealing as new data emerges. And, conversely, some companies that first looked to be in dire straits now look golden (a movie-producer friend of mine was initially lamenting about the inability to shoot films on location but then realized that his firm's extensive animation business started to boom as Netflix was demanding more content for its "stay-at-home" subscribers and that the animators can easily work remotely).

As lucky companies are separated by investors from unlucky companies as the impact of the pandemic evolves, we should expect continued market volatility. But, it has become a "stock-pickers" market for the first time in years. The markets may be heading for a roller-coast ride, but it may be a smoother ride for portfolios with the right stocks.

Portfolios with the right stocks or sectors may see less volatility than the overall market.

[1] J.J. Kinahan, "'Whatever We Can, For As Long As It Takes': Fed Committed to Long-Term Economic Support With Low Rates". *Forbes*, June 10, 2020.

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 during first half of June.

For the four weeks up to mid-June, stocks across the board (U.S., Canadian, and international) made significant advances despite some recent choppiness. Stocks have been an important contributor to the recovery in the model portfolios. We rebalanced the model portfolios twice: once in February and once in March. This helped to capture a little more of the upside as each rebalancing slightly increased the weighting of stocks relative to bonds.

Taking a cue from the recent choppiness, we could face a period of increased volatility as investors try to justify some of the more excessive valuations and as the U.S. waffles on the next fiscal stimulus package. Delays are plaguing another $1 trillion USD spending package (legislators are going on summer recess and policymakers are trying to do some

No changes were made to the model portfolios the first part of June.

Stocks continued their run although mid-June saw some choppiness.

Investors may take some time to reassess current valuations and the chances for another large economic stimulus package in the U.S.

[2] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 6/17/2020. 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.

analysis of the effectiveness of the last package before proceeding). However, with a U.S. presidential election looming on the horizon, and with President Trump positioning himself as the "economy-friendly" candidate, it would be a little surprising if the package does not get enacted sometime this summer. However, investors might be on the sidelines until they see some progress on this legislation.

The financial news recently has been filled with headlines about home-trapped millennials and sports gamblers taking up day-trading (because most sports are on a Coronavirus hiatus) and driving the shares of technology companies and other well-known high-flying growth companies higher. As mentioned in the first section of this *Monthly Letter*, this activity has probably added to the overall advance in stocks over the last few months. So, what happens if these rookie day-traders start racking up losses and need to sell their positions? Perhaps technology and growth stocks will be at more risk than staid companies (the type that we tend to hold more of in the model portfolios). That may be enough to put downward pressure on the various stock market indices but have less impact on portfolios that avoided many of the high-flyers.

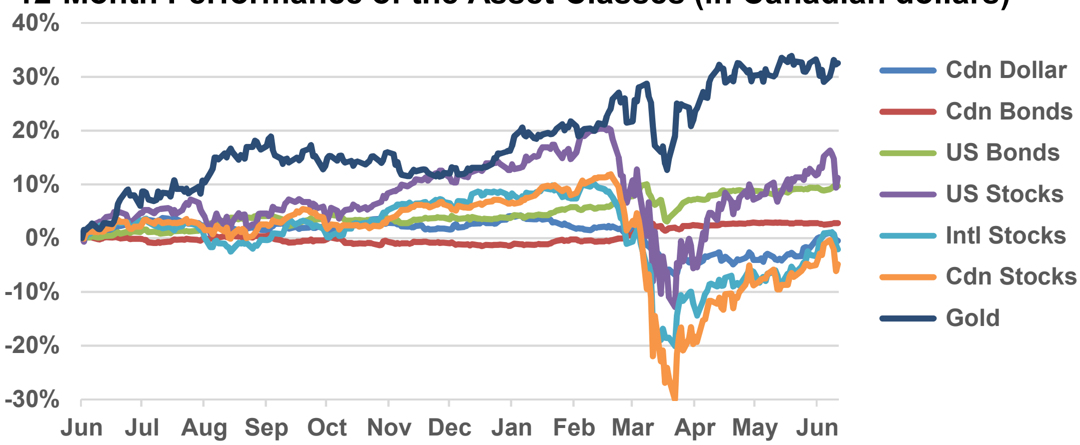
Stories of rookie day-traders driving up technology & growth stocks. May not be sustainable if they begin to incur losses and need to sell.

But, most of this has not impacted more solid & boring companies as much.

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**).[3]

Chart 4:

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



Source: Bloomberg Finance L.P. from 6/1/2019 to 6/17/2020

[3] 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[4]

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

[4] 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 June 17, 2020.

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