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Economic & Market Update

Gold

The weak economic numbers suggest that gold should not be back … But it is.

As of the date of this publication, the spot price of bullion is trading at a record high. It's up over 37% over the last 12 months (in U.S. dollar terms).[1] Since initially adding gold bullion to the model portfolios in April 2004, the price is up 433%, which equates to a compounded annual return of 10.86%. Not bad for the "barbarous relic" (as nicknamed by John Maynard Keynes). Since September 2005, it has been the best-performing asset class in our model portfolios (**Chart 2**), despite a four-year 44% decline starting in

Who's going to pay for all this new Coronavirus-related government spending?

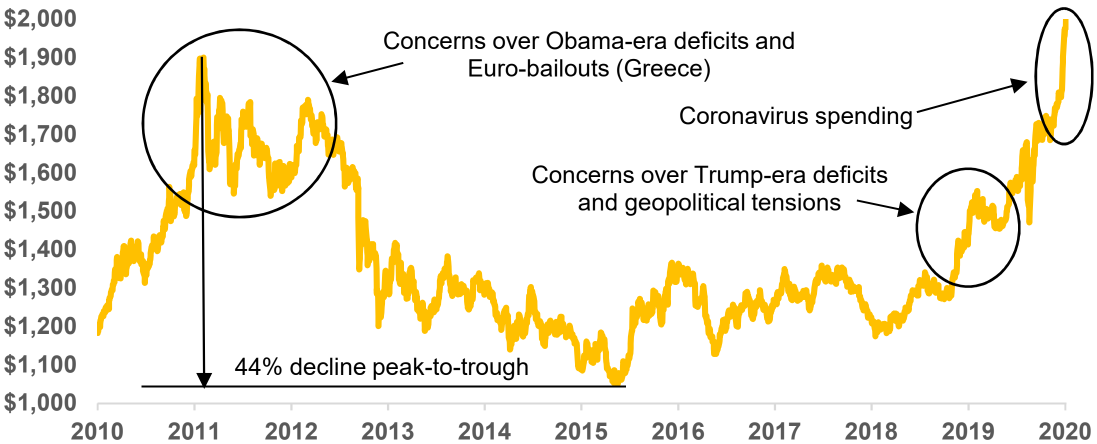
As long as there is no clear answer to this question, gold may be a beneficiary.

[1] Source: Bloomberg Finance L.P. as of 8/5/2020.

September 2011 (**Chart 1**). It is also the largest single holding in the model portfolios, becoming slightly larger this March when we added to the position during the Coronavirus-related market turmoil.

Gold has been our best-performing asset class since being added to the model portfolios in 2004.

Chart 1:
Gold Price (U.S. dollar spot)



Source: Bloomberg Finance L.P. as of 8/5/2020

Gold began its current liftoff in May of last year. At the time, I was writing about accelerating U.S. government budget deficits and how the non-partisan U.S. Congressional Budget Office was forecasting continued heavy debt growth well into the future. The Trump administration's annual spending had already passed the previous spending records set by the Obama administration partly because of President Trump's tax cuts which levelled off tax revenues, and because there was no real opposition to spending from either party in Congress. The last notable opposition was the Tea Party wing of the Republican party in the early part of the last decade, but that has essentially dwindled down to one senator from Tennessee.

Our bullion position has outperformed stocks even when considering the dividends that stocks have paid.

Investors have been paying more attention to gold since deficit spending became a growing concern last year.

Then the Coronavirus hit and the U.S. government, as well as governments throughout the world, launched super-massive economic spending packages to provide relief. Parties of all stripes now advocate nearly-unrestrained spending. The only differences involve the focus and duration of the spending.

Now, deficits are set to explode with Coronavirus-related spending.

There aren't many believable scenarios that return us to balanced budgets anytime soon. Cutting spending or increasing taxes are policies that voters don't like, especially with an economy being severely impacted by the pandemic. Most avenues are beginning to point towards money-printing as a response.

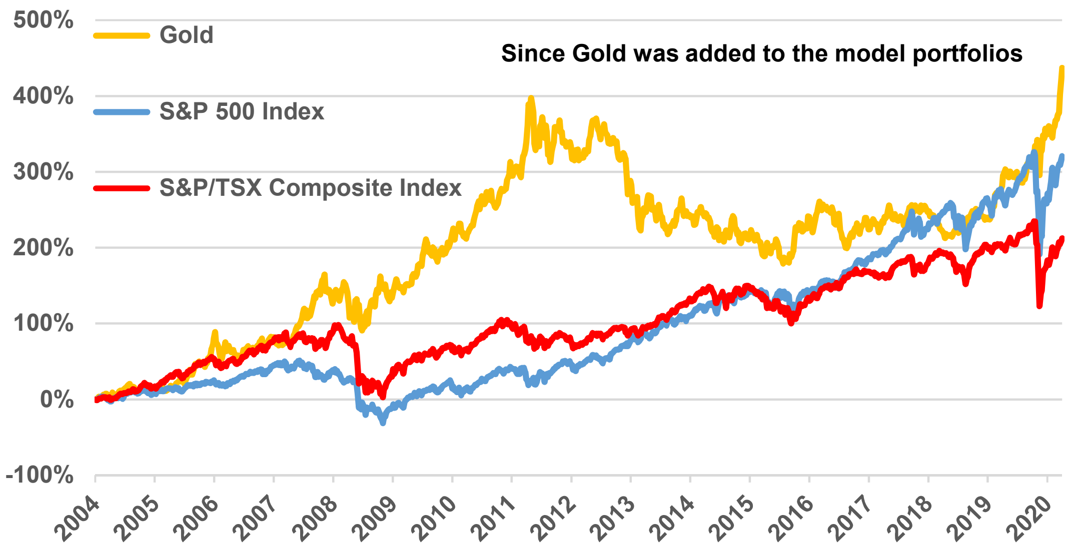
Balanced budgets appear to have disappeared for the foreseeable future, unless governments are tempted by money-printing.

Gold investors might have started to arrive at such a conclusion around this time last year, creating a foundation of demand for the metal upon which the current rally has been built.

Gold investors may have concluded last year that some money-printing was inevitable.

Chart 2:

Gold vs U.S. & Canadian Stocks (Total Return including Dividends)



Source: Bloomberg Finance L.P. as of 8/5/2020

Recently, there have been a few other contributing factors to gold's rise. The first is some global weakness in the U.S. dollar as the risk appetite of investors in general has increased (as witnessed by higher stock prices and some areas of speculation). This induces a shift away from safe havens like the U.S. dollar. However, the overhang of global debt may attract people back to the U.S. dollar as it tends to look the least ugly in times of turmoil. If the U.S. dollar does eventually strengthen, it could provide a headwind for gold prices, but unlikely enough to seriously dampen demand.

Gold is also being helped by some potentially temporary U.S. dollar weakness and by geopolitical concerns between the U.S. and China.

Secondly, growing geopolitical tensions, primarily between the U.S. and the People's Republic of China, might have pushed more investors into gold over the past few months. However, in the past, moves in gold prices in response to a geopolitical or military crisis tend to be very temporary.

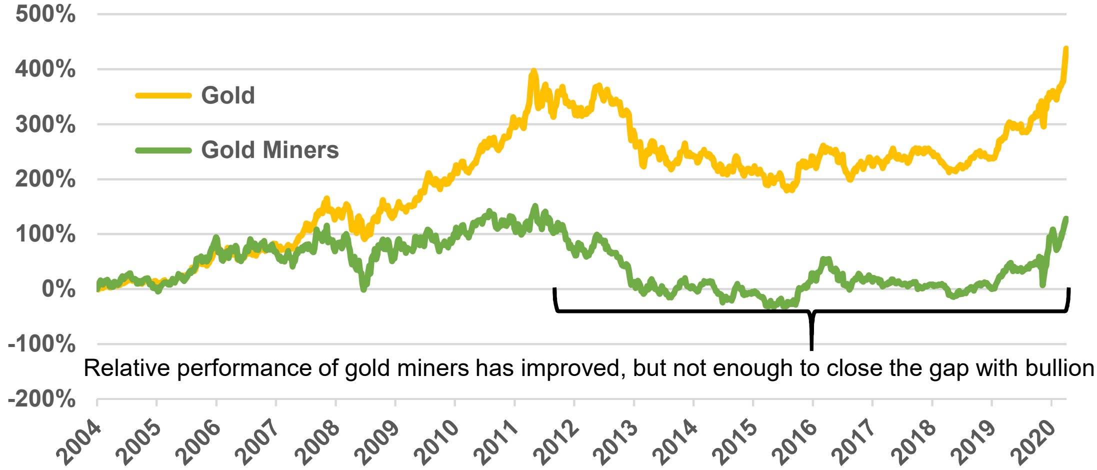
The model portfolios' exposure to gold is purely in the form of bullion. It has been more than a dozen years since I have invested in a gold mining company or an ETF index comprised of gold producers. This was the result of frustrating experiences involving the management of mining companies. Often, they would "hedge" their gold production at inopportune times, or would have trouble managing costs which would impair their ability

We have preferred to hold bullion rather than invest in mining companies. Fortunately, it looks like we have been rewarded for this.

to leverage their operations in order to take advantage of periods of rising gold prices. As (**Chart 3**) indicates, we weren't missing much by focusing solely on bullion.

Chart 3:

Gold vs Gold Mining Stocks (iShares S&P/TSX Global Gold Index ETF)



Source: Bloomberg Finance L.P. as of 8/5/2020

Over the last few hundred years, gold has generally risen in price as paper currencies have been devalued because of the monetization of debt (in other words, printing money to pay off bondholders). In liberal democracies, political candidates naturally get too enthusiastic with promises that taxpayers cannot eventually afford to pay for. The slow decline in fiat currencies tends to be a mirror inverse of gold's long-term advance (except for periods when governments legislated a fixed gold price). Gold does consolidate over some intervals, either naturally as the rate of currency devaluation slows or unnaturally when the price of gold is fixed by law, followed by a period of escalation.

Now, with the unprecedented levels of Coronavirus-related spending, we might be at the onset of one of those stretches of escalation.

In the next issue, I will try to add some context with respect to the increase in government debt as a result of all the new spending as well as just how much gold there is in the world (it is a finite and measurable amount and it is relatively stable as mining production does not have the capacity to significantly add to the total over short and medium lengths of time).

Gold has been on a long march upwards as fiat (paper) currencies have been devalued because of perpetual overspending by governments.

Occasionally there are rapid periods of escalation in gold prices as investors rush to add it to their portfolios. We might be entering such as period.

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 the month of July.

No changes were made to the specific investments or to the asset allocations during July.

The star contributor of the month was gold (see the above section) as it rose over 14% in Canadian dollar terms. Much of that near-term gain has been driven by global U.S. dollar weakness stemming from negotiations in the U.S. Congress with respect to the next phase of the federal Coronavirus stimulus package (anywhere between $1 trillion and $3 trillion – regardless of the exact amount, we are talking trillions here!)

Gold was the major contributor to results during the month as investors look for potential inflation hedges to guard against any fallout from massive government spending.

Continuing with the theme of a weaker U.S. dollar as investors' appetite for risk has led them to destinations outside the U.S. for now, the Canadian dollar has been a benefactor. Fiscally, the deficit and debt situations are not much different in Canada compared to the situation in the U.S. That said, it appears that currency traders are being relatively kind with the Canadian dollar. This mood is especially evident with the Australian dollar which

[2] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 7/15/2020. 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.

was trading below 60 cents to the U.S. dollar as recently as early April but has now skyrocketed to almost 72 cents.[3]

Relatively weakness in the U.S. dollar has hardly been enough to dent the positive contributions from the main asset classes in the model portfolios, but the exchange rate has tempered the full potential nor now. However, I am wagering that the U.S. dollar will find strength when some aspects of a challenging global economic reality begin to hit the psyche of investors.

Over the near-term, the analytical focus will continue to be on an incremental recovery involving earnings, wages, employment, and economic growth. With progressively higher valuations, there is a risk that investors could react adversely if there are setbacks in these areas compared to expectations. Also, the geopolitical strife between the U.S. and the People's Republic of China warrants attention as it may be amplified by the two candidates for U.S. president as they try to out-do each other with patriotic rhetoric. This could add to late-summer/early-autumn market volatility.

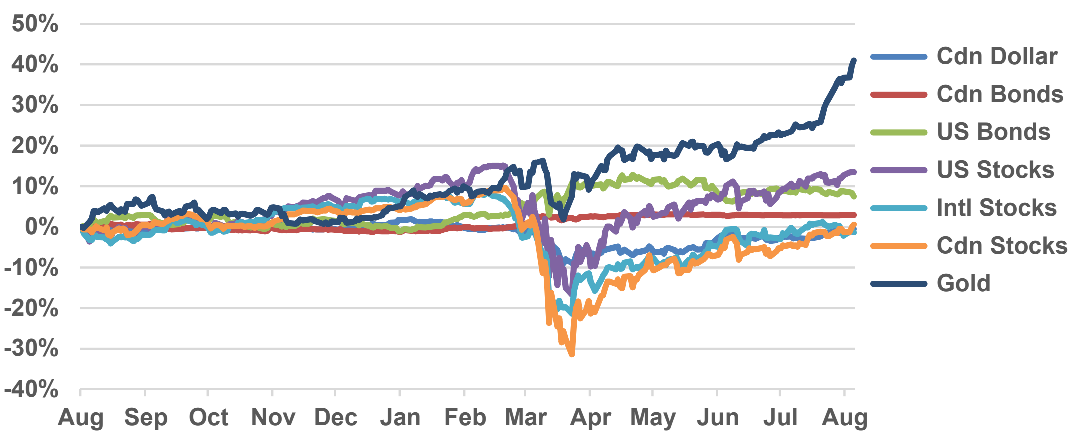
The focus over the next few months will be on the pace of the recovery and the number of setbacks that emerge.

Also, the growing spat between the U.S. and China will need to be monitored.

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 8/1/2019 to 8/5/2020

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[3] Source: Bloomberg Finance L.P. as of 8/5/2020.
[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.

TD Wealth

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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 August 5, 2020.

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