TD Wealth

The Charter Group Monthly Letter

Mark Jasayko, MBA, CFA
Portfolio Manager & Investment Advisor
TD Wealth Private Investment Advice
The Charter Group, Langley, BC

Economic & Market Update

Gold II

In the August issue of *The Charter Group Monthly Letter* I outlined some of the recent history of gold prices starting when bullion was added to our model portfolios, talked about why we lean towards bullion as opposed to gold miners, and touched on how ambitious campaign promises have lifted the price of gold over the very long-term.

A little more context on the last point may help to provide some perspective on where gold prices might trend over the next number of years.

Elections in liberal democracies tend to be hallmarked by unbridled optimism as candidates try to compete by describing how much better the future will be if the electorate

The total amount of gold mined throughout history is known with reasonable accuracy.

Applying the current spot price tells us what the total value of all that gold is, which can then be compared against total debt numbers.

votes for them. Usually this entails promises of spending with some half-hearted attempts at explaining how the spending will be financed.

Political candidates are usually optimistic by nature.

Optimism can lead to increased spending without a realistic plan to pay for it.

As a victorious government proceeds through its mandate, if often becomes clear that a budget deficit will persist. The country's central bank could be persuaded to play a role that facilitates the financing of the deficit without the need for the government to raise taxes. For example, it has become normal for central banks to print money to buy government bonds hoping that the government will someday run a budget surplus allowing it to retire the bonds at maturity. Instead, the more common conclusion is that deficits pile up, forcing central banks to print more money to buy more newly-issued government bonds. The result is an ever-expanding money supply with scant hope of the bonds being paid off. Maturing bonds roll over into new bonds on top of even more new bonds needed to finance another annual deficit.

As deficits become apparent, issuing debt (via bonds) often becomes the most favoured choice of financing. It's easier than raising taxes or cutting the spending later.

One legacy of all this is a devalued currency. As central banks expand the money supply to buy the bonds, there is simply more money in circulation chasing a relatively constant amount of goods and services. As time passes, money doesn't buy as much as it used to. The devaluation is apparent when measured against the value of real assets.

It is now common for central banks to print money to buy much of that government debt.

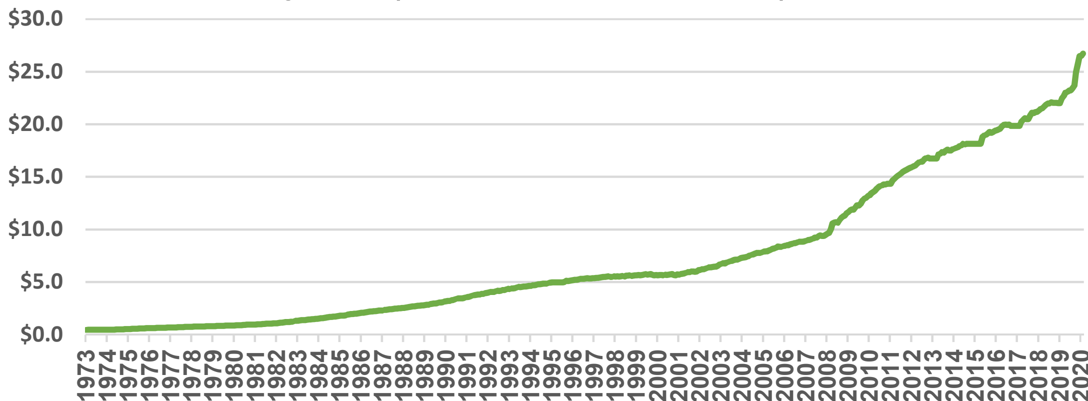
Many gold investors see bullion as a hedge against this perpetuating cycle. But, how did gold attain this currency-hedging attribute?

This keeps interest rates down, but expands the money supply.

An expanding money supply could spark inflation.

Chart 1:

Total U.S. Treasury Debt (in trillions of U.S. dollars)



Source: Bloomberg Finance L.P. as of 9/8/2020

First, gold is generally seen as a form of money despite its relative inconvenience. In very general terms it is accepted in exchange for paper currency (however, it tends not to be accepted in exchange for goods or services, so it is far from a perfect substitute, but close

Gold is viewed by many as a hedge against currency devaluation and inflation.

enough).

Secondly, the supply of gold is relatively fixed. In 2019, total gold production only added about 1.8% to global supply.[1] It is this feature of a relatively fixed supply that adds to its stability as a hedge against currencies where the money supplies can be increased electronically, significantly and instantly.

Gold's supply is relatively fixed which contributes to its stability compared to a paper currency whose supply can be highly variable.

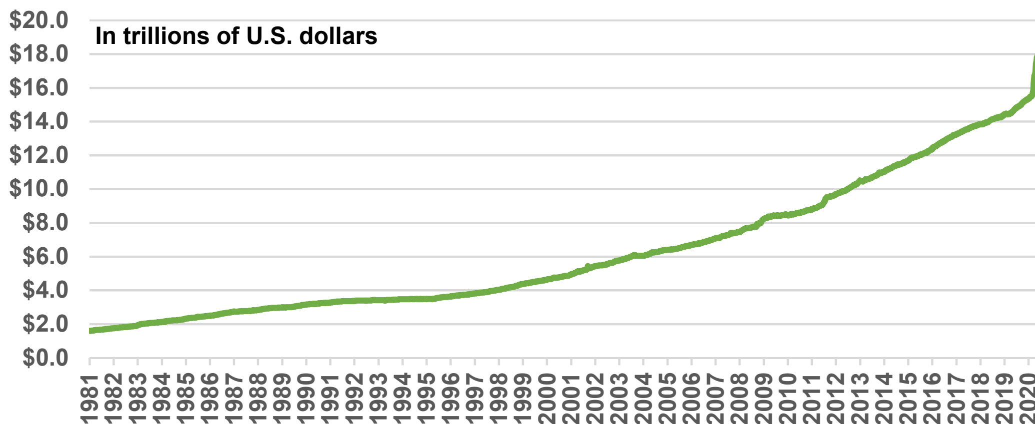
So, what is the value of this global supply? The World Gold Council estimates that the total gold mined throughout history currently totals 197,576 tonnes[2] which equates to 6,352,068,400 troy ounces. The current spot price is $1,934 USD.[3] As a result, the total value of all the gold ever brought to the surface is almost $12.3 trillion USD.

When I was in college in the 1980s, "trillions" rarely ever entered into the nomenclature of economics. Nowadays, many of the comparative reference points are in the trillions. The total debt issued by the U.S. Treasury is $26.7 trillion (**Chart 1**). So, if somehow the U.S. Treasury was able to confiscate every gold bar, every item of gold jewelry, every gold filling, and reclaim every ounce of gold from industrial uses, it would not even pay off half of the current total U.S. Treasury debt. And, this is only the current debt. The non-partisan U.S. Congressional Budget Office now projects a cumulative budget deficit of $13.0 trillion from 2021-2030 which would push total U.S. Treasury debt to about $40 trillion by the end of that period, more than triple the value of all the gold in the world.[4]

All the gold in the world wouldn't be enough to pay off half the current U.S. federal debt.

Compared to the debt and obligations of governments throughout the world, there is not that much gold out there.

Chart 2:
U.S. Money Supply (M2 Definition incl Money Market Funds & Time Deposits)



Source: Bloomberg Finance L.P. as of 9/8/2020

[1] "Gold mine production." World Gold Council, April 2019.
[2] World Gold Council, August 2020.
[3] Source: Bloomberg Finance L.P. as of 9/8/2020.
[4] "An Update to the Budget Outlook: 2020 to 2030." Congressional Budget Office, September 2, 2020.

Current U.S. money supply is almost $18.4 trillion (**Chart 2**). So, we know with certainty that the U.S. dollar *is not* backed by gold like it used to mainly because there is a lot more of it than there is gold in the world. Plus, it is important to note that we are only talking about the U.S. here. There are a multitude of other countries around the world that run significant budget deficits and risk similar currency devaluations.

If governments continue to over-promise, the future of gold looks bright.

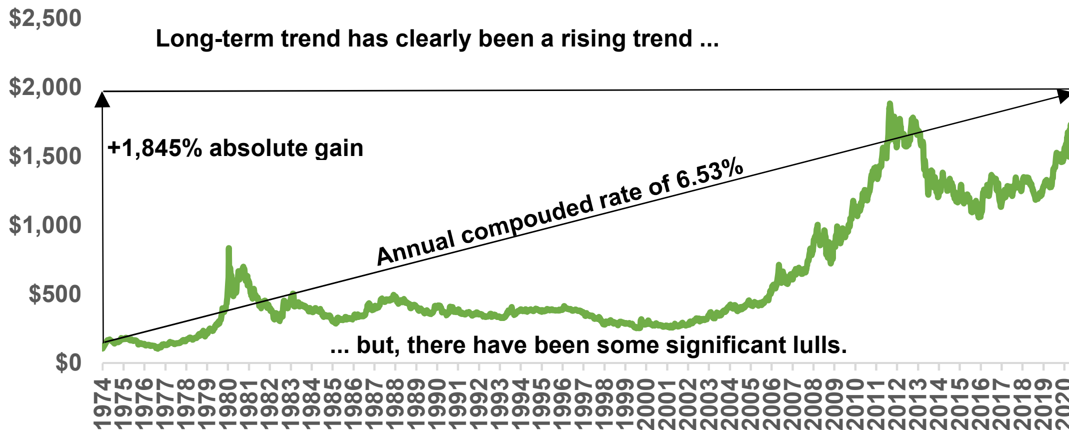
Considering all this, it looks like paper currency money supplies are very likely to escalated upwards. Will the price of gold bullion reflect this by rising? Very likely. However, its rate of increase is not that predictable. During the free-floating currency era beginning in late 1973, the price of gold has not gone up in direct correlation with the expansion of money supplies around the world. There is some ebb and flow in the psychology surrounding the fear of currency devaluation. Plus, the offshoring of manufacturing in the post-Cold War period helped to slow the rate of inflation which moderated the price of gold for almost two decades. However, despite these fits and starts, gold has increased over 1,800% since late 1973, equating to an annual compounded rate of 6.53% (**Chart 3**).

Important to note that gold's incline is often not a straight line because of other intervening factors.

However, over the long-term, gold's tendency to rise in price become clear.

Chart 3:

Gold (Spot Price in U.S. dollars per troy ounce)



Source: Bloomberg Finance L.P. as of 9/8/2020

Recently, gold has given us a glimpse of how it reacts to concerns over significant increases in budget deficits (primarily because of Coronavirus-related emergency spending). It is impossible to forecast how the price of gold will behave from year to year. However, governments around the world are doing their best to raise investor anxiety over potential loss of paper currency purchasing-power. The long-term future performance of gold may reflect its long-term past.

Massive Coronavirus-related spending has recently highlighted gold's virtues as a hedge, reflected by a significant jump in price.

Model Portfolio Update[5]

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 August.

No portfolio changes during August.

After rising over 30% from mid-March during the midst of the Coronavirus equities selloff, gold took a bit of a breather in August. The Canadian dollar / U.S. dollar exchange rate also weighed on the model portfolios a little as a weaker U.S. dollar reduced the returns on U.S. dollar-denominated investments.

Gold levelled off after four very good months.

However, the advance in equities in the U.S., Canada, and internationally all helped to offset those negative effects, pushing the model portfolios back towards their pre-Coronavirus highs.

August was a very good month for stocks around the world which helped the model portfolios to recapture pre-Coronavirus levels.

The weaker U.S. dollar was a function of investors' greater risk appetite. Basically, this is opposite of when investors rush towards the U.S. seeking a safe harbour in times of worry.

[5] 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.

Something to watch during September are the lofty valuations on a number of the large growth companies (mainly technology firms) that were leading the indices higher over the last number of months. September has been the worst month for stocks over the last seven decades as investors often sober up after a carefree summer.

Rich valuation of technology stocks could add some volatility during September.

September is often a time of year when investors reassess things after a summer lull in corporate and economic activity.

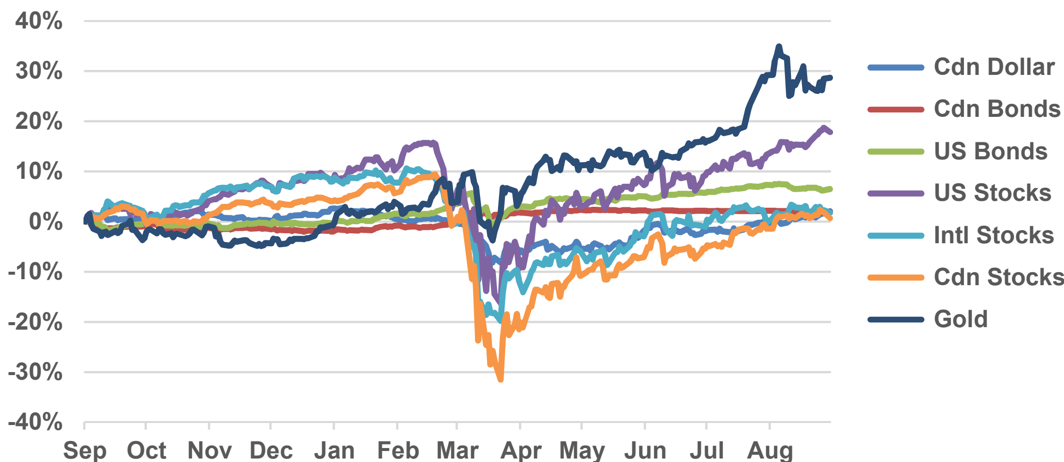
Additionally, we are heading into the homestretch for the U.S. presidential election. Although there is little to distinguish between President Trump and former Vice-President Biden in terms of fiscal profligacy, the race for control of the U.S. Senate could have an impact on markets, especially if it looks like the Senate majority will line up with the party that wins the presidency. Generally, markets tend to prefer the gridlock posed by a counter-balance. Conversely, investors could get agitated if it looks like passing major legislation will become easier.

The beginning of the homestretch of the U.S. presidential election could become a focus for investors.

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**).[6]

Chart 4:

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



Source: Bloomberg Finance L.P. from 9/1/2019 to 9/1/2020

[6] 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[7]

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

[7] 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.

The Charter Group

Mark Jasayko, MBA, CFA | Portfolio Manager & Investment Advisor
Mike Elliott, BA, CIM, FCSI ® | Portfolio Manager & Investment Advisor
Laura O'Connell, CFP ®, FMA | Associate Investment Advisor
Kelsey Sjoberg | Client Service Associate

604 513 6218
8621 201 Street, Suite 500
Langley, British Columbia V2Y 0G9

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 September 8, 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.

Certain statements in this document may contain forward-looking statements ("FLS") that are predictive in nature and may include words such as "expects", "anticipates", "intends", "believes", "estimates" and similar forward-looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest and foreign exchange rates, equity and capital markets, the general business environment, assuming no changes to tax or other laws or government regulation or catastrophic events. Expectations and projections about future events are inherently subject to risks and uncertainties, which may be unforeseeable. Such expectations and projections may be incorrect in the future. FLS are not guarantees of future performance. Actual events could differ materially from those expressed or implied in any FLS. A number of important factors including those factors set out above can contribute to these digressions. You should avoid placing any reliance on FLS.

Index returns are shown for comparative purposes only. Indices are unmanaged and their returns do not include any sales charges or fees as such costs would lower performance. It is not possible to invest directly in an index.

The Charter Group is a part of TD Wealth Private Investment Advice, a division of TD Waterhouse Canada Inc. which is a subsidiary of The Toronto-Dominion Bank.

Bloomberg and Bloomberg.com are trademarks and service marks of Bloomberg Finance L.P., a Delaware limited partnership, or its subsidiaries. All rights reserved.

All trademarks are the property of their respective owners.

® The TD logo and other trade-marks are the property of The Toronto-Dominion Bank and its subsidiaries.