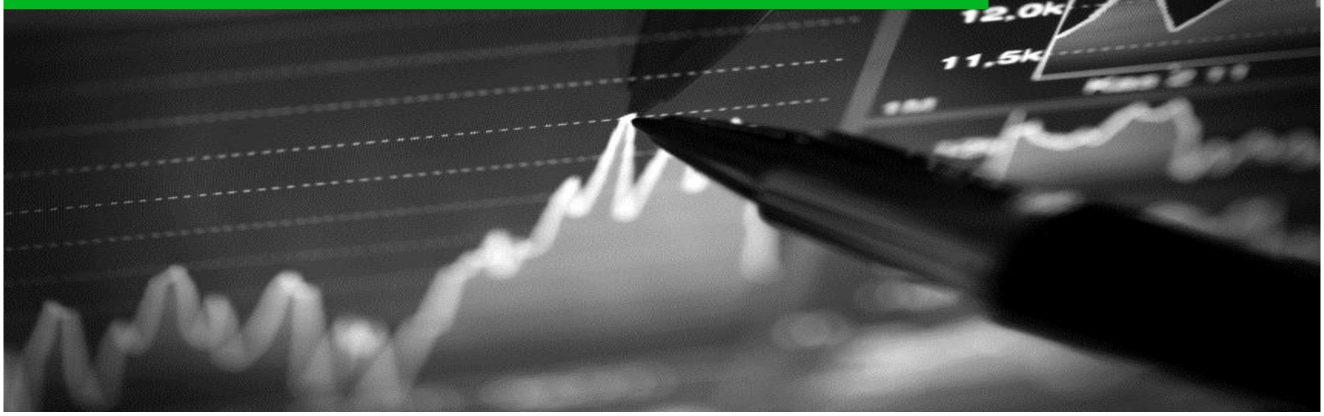
TD Wealth

# The Charter Group Monthly Letter

November 2020 Issue 71



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## Economic & Market Update

### Mr. Market Casts A Ballot

Mr. Market is an imaginary character originally devised by Ben Graham, the Father of Value Investing, in his 1949 book, *The Intelligent Investor*. Mr. Market is plagued by wide emotional swings reflected in his willingness to buy or sell businesses at prices that hardly reflect the underlying fundamental values of the companies involved. Mr. Market ran for the hills this last March when Coronavirus concerns prevailed, and then rushed into speculative stocks with uncertain futures when it appeared that the economy might recover better than expected.

**Are the investment markets a better political barometer than the professional pollsters?**

However, these cases illustrate how Mr. Market reacts when responding to *unexpected* news. Very few saw extreme uncertainty that hit markets in March. Subsequently, not many saw the better-than-expected rebound in April and May. Investors, as a whole (aka, Mr. Market), were forced to absorb new information in real-time, leading many of them to make bold investment decisions (although there were rare exceptions, most of these bold decisions have not resulted in superior performance).

**Often the market can get emotional, but with foreseeable events, it is often less emotional than the general population.**

**Elections are a case in point.**

Despite these flaws, Mr. Market does have a few redeeming attributes. Often, as more information becomes available, Mr. Market becomes less vulnerable to making egregious investment pricing errors. Also, if an upcoming event is anticipated, Mr. Market tends not to be lulled beforehand and then surprised when the event occurs.

Ships only hit the icebergs they don't see.

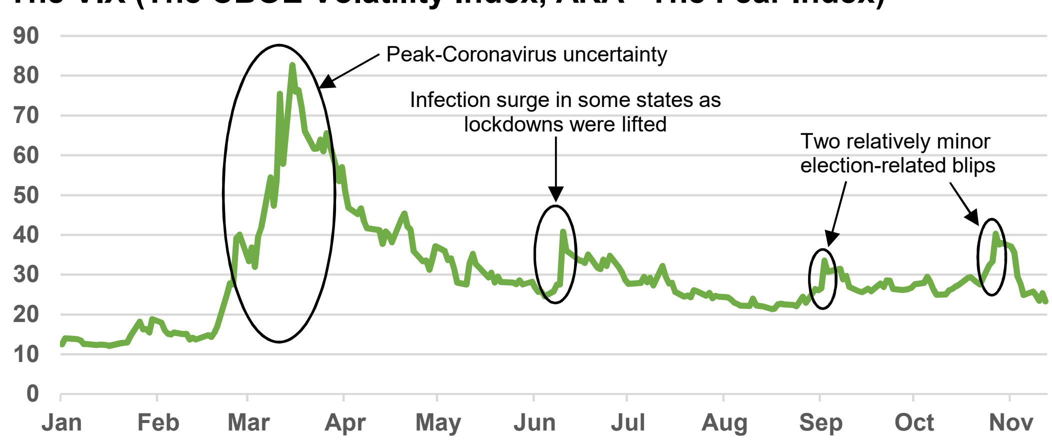
If we go back to September, everyone knew the presidential and congressional U.S. elections would occur on November 3rd. There was much discussion regarding the potential for a lopsided result, introducing the risk for relatively radical new policies over the next four years. There was also chatter about a disruptive period if it was not immediately evident who had won the presidential race, and further disruption if this impacted the smoothness of a White House administrative transition, if one was required.

**Markets did not appear to assign likely probabilities of worst-case post-election disruption.**

While it was relatively easy to conjure up how worst-case scenarios would look, Mr. Market did a pretty good job at assessing a whole range of outcomes and not assigning a very high probability to any single one result. Worst case scenarios can occur, but they may not be as probable as political pundits make them out to be.

**Chart 1:**

**The VIX (The CBOE Volatility Index, AKA "The Fear Index)**




Source: Bloomberg Finance L.P. as of 11/20/2020

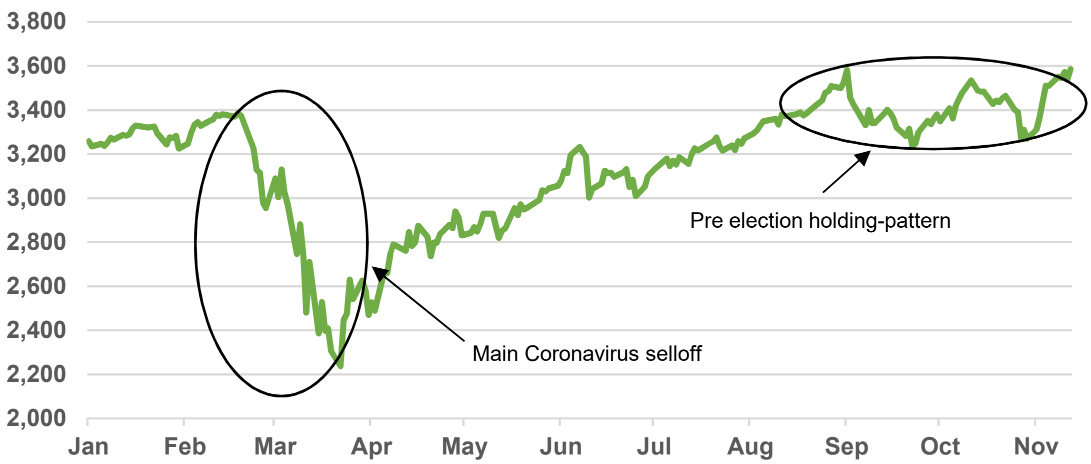
To get a sense of Mr. Market's expectations regarding the U.S. election, the VIX (or the Chicago Board Options Exchange Volatility Index) might offer a hint as it attempts to gauge stock market volatility over an upcoming 30-day period (**Chart 1**). Thirty days before the elections on November 3rd, the VIX hardly moved. There was a bit of a spike in the VIX during the week before the elections, but that paled in comparison to where the VIX was during March. Immediately following the election, the VIX promptly fell back to the level last seen in late August.

**Fear-gauge readings and stock market behaviour before the elections were relatively subdued.**

Mr. Market's mood was also captured by the U.S. stock market before the elections. Although the S&P 500 Index did sell off during the latter half of October, it only fell back to the level from four weeks prior when concerns related to the elections were already being thoroughly discussed by market participants (**Chart 2**).

**Chart 2:**

**S&P 500 Index (U.S. Large Company Stocks)**




Source: Bloomberg Finance L.P. as of 11/20/2020

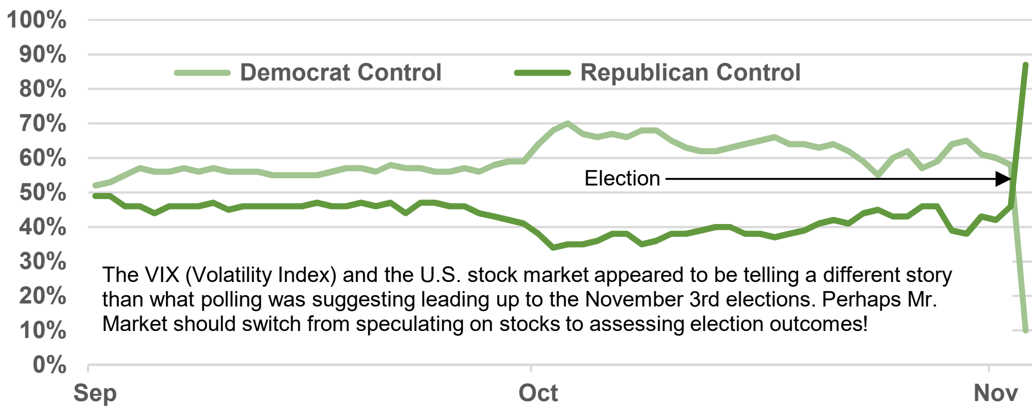
In retrospect, Mr. Market looked much more grounded than the pollsters. With some minor exceptions, the pollsters were pointing to a presidential race, a U.S. Senate battle, and a strengthening majority in the U.S. House of Representatives all heading in the same partisan direction. It appears that they got the presidential race right, but far from the margin that they were expecting. The result for the Senate did not go according to expectations based on polling (**Chart 3**), and the Democrat majority in the House was unexpectedly weakened.

Messages conveyed by the market are bolstered by the fact that investors are committing real money when making decisions regarding the future. Polls, however, are subject to samples that only include willing participants and may not capture likely probabilities if enough of the willing respondents are not completely honest. Plus, opinion polls are only useful if they are consummated with actual votes. Voting requires more effort than merely responding to a poll question.

Since the elections, the U.S. political playing field looks much more centrist than the pre-election polling suggested. And, guess what, investors like that. A little bit of gridlock can put the brakes on ambitious and expensive economic policies. More negotiation, more thought, and more compromise will need to be part of the legislative process.

**Chart 3:**

**Implied Probabilty from Polling for 2020 Senate Party Control**




Source: Bloomberg Finance L.P. and PredictIt.org as of 11/20/2020

**Markets may be pointing to a brighter post-election period than the opinion polls which mostly communicated anxiety.**

It is also important to note that U.S. federal election cycles are tightly condensed. *Every* congressperson who won on November 3rd of this year will have to run again on November 8th, 2022. Plus, one-third of all U.S. senators are up for re-election on that date. It is natural that many within this group are not keen on passing experimental or radical economic policies. Often the drama of media coverage on political issues overlooks how pragmatic politicians can become in order to secure re-election. American voters predominantly push things towards the centre during mid-term elections, and most seasoned politicians know this. This adds to the compromise that Mr. Market prefers.

While it may not be prudent to listen to Mr. Market when his emotions are driving up the prices of stocks like Tesla for instance, his relatively calm demeanor which contrasted with the forecasts of mayhem from political pundits in the months before the U.S. elections might be something that provides some useful insights with respect to the investment and political landscape next year.

## 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 |

There were no changes to the specific holdings or the targeted overall asset allocation in the model portfolios in October.

**No changes in the investments or the overall asset allocations in the model portfolios over the last month.**

During October, most markets were in a holding-pattern ahead of the November 3rd elections in the U.S. Towards the end of October, asset classes had mostly settled back to where they were when the campaigning began in earnest at the beginning of September. As a result, there was not much movement in our model portfolios from the beginning to the end of this stretch.

**Stocks saw a mild selloff towards the end of October, but that only took us back to September levels.**

When there was more clarity with the political and economic landscape following the elections, the markets got some considerable lift. Investors approved the prospects involving a Biden administration combined with a somewhat divided Congress.

[1] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 11/20/2020. 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.

The U.S. Federal Reserve Board recently signaled that they will provide the monetary policy needed to accommodate additional trillions of dollars of Coronavirus-related assistance. Plus, the potential candidates to fill the role of U.S. Treasury Secretary in January are all thought to prefer spending over austerity. Investors appear to be in favour of the further economic assistance that these developments imply. However, as they indicated during the Democrat primaries back in the Spring, investors are not keen for policies like extremely expensive Green New Deals. Those appear to be off the table for now.

**Markets may be anticipating a sugar-high related to more Coronavirus spending.**

**However, markets appear relieved that expensive radical new policies seem to have been de-prioritized.**

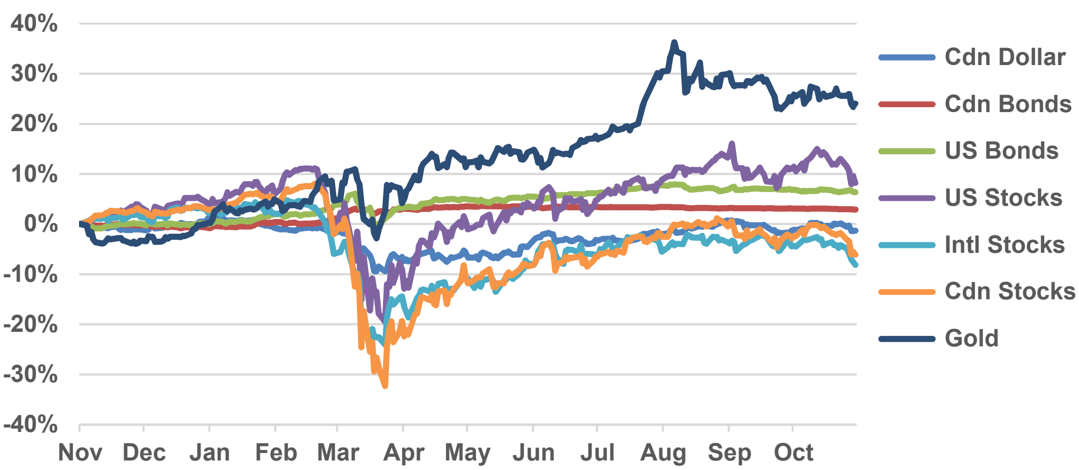
There has also been some encouraging vaccine news from Pfizer, a pharmaceutical company, which could signal the beginning of the end for the Coronavirus pandemic. As we hold Pfizer in the portfolio, we have been following these developments for a while and were not surprised by the timing of the announcement. However, the efficacy of the vaccine trials was definitely better than expected. The markets responded very positively to the news, perhaps expressing more good hope for 2021.

**Encouraging vaccine news could provide a sturdier foundation for investment returns in the short- to medium-term.**

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**).[2]

**Chart 4:**

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




Source: Bloomberg Finance L.P. from 11/1/2019 to 10/31/2020

[2] 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[3]

| 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 |

[3] 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 November 20, 2020.

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