TD Wealth

# The Charter Group Monthly Letter

December 2020 Issue 72

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## Economic & Market Update

### Sometimes Doing Nothing is Doing A Lot

**There are times when investment managers can end up "chasing their tails" if they trade too much.**

Some have attributed the above phrase to Mark Twain. Over the years I have used it to describe the potential pitfalls associated with overthinking or jumping to hasty conclusions which might have to be reversed.

Following the selloff in stocks this March, it was interesting to see how investment managers responded. There appeared to be a consensus among managers that interest rate cuts and massive government aid money would help to buoy the economy and set a foundation following the uncertainty surrounding the initial impact of the Coronavirus. This consensus was manifested in stocks bouncing off their lows as well as the order that was re-established in the bond market.

As April progressed there was some divergence in the behaviour of active money managers. The headlines were filled with prognostications with respect to which companies and sectors would do well in the new Coronavirus world, and which would suffer. Many of these observations where based on first order effects: looking at the initial impact and extrapolating this out into the future. It is intuitive for many investors embrace an extrapolation of current events. Even professional investors can be tempted to do that.

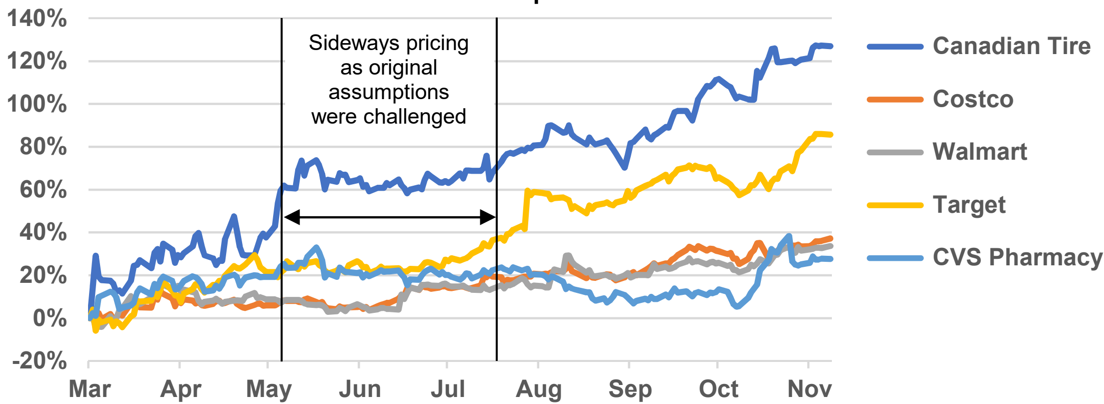
**As the markets recovered from the March lows, many investors made bold decisions.**

**As further news emerged, some of the original assumptions were challenged.**

**Chart 1:**

**Large Retail Stocks Since the Market Bottom on March 23rd, 2020**

**With a Focus on Basic Consumer Staple Goods**




Source: Bloomberg Finance L.P. as of 15/9/2020. We hold Canadian Tire & CVS Pharmacy in The Charter Group Model Portfolios.

However, it quickly became evident that second- and third-order considerations interfered with those extrapolations. For instance, some investors were enticed to buy large consumer product retailers on reports that people were hoarding things like toilet paper. However, the boil came off that trade when it dawned on investors that many of the products being hoarded were non-perishable. In those cases, people were merely accelerating purchases that they would have eventually made anyways. As a result, over the long-term, there wouldn't be more-than-normal purchasing of these consumer goods. People would eventually start winding down their inventory at which point purchases would ebb for a period. The eventual conclusion was that in many cases hoarding would only be a one-time thing and would not be the recurring source of revenue that spawned the initial excitement.

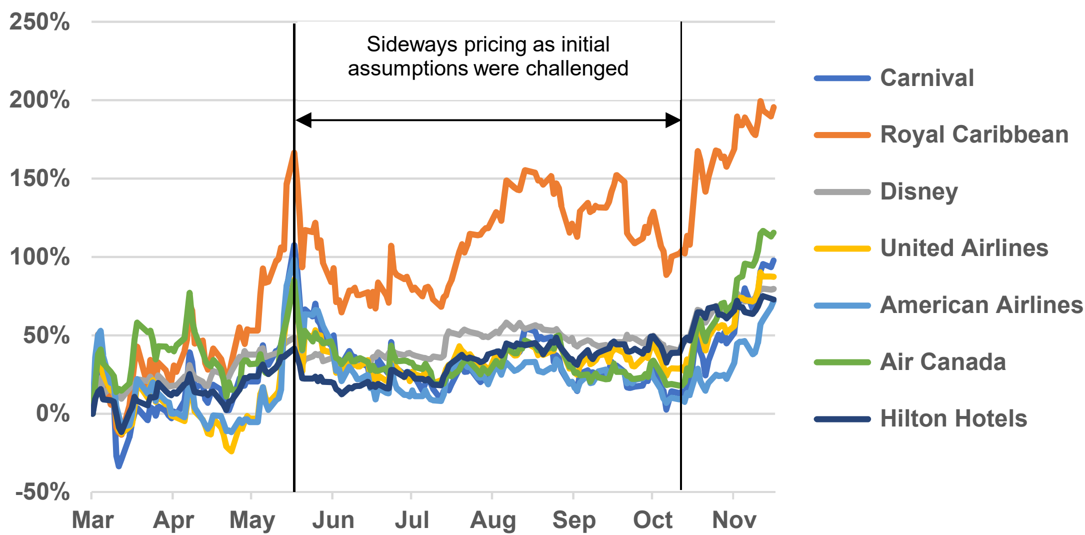
**Sideways price trends as we entered late Spring may have been evidence of a breakdown of the early bullish consensus regarding big retailers and stay-at-home stocks.**

Investors that were early buyers of the big retailers were subject to some sideways price movement, as well as some declines as further data and analysis challenged early assumptions with respect to the potential of certain companies to do well (**Chart 1**).

Similar patterns driven by different factors also impacted other industries, especially the travel sector (airlines, cruise lines, hotels) (**Chart 2**) where many investors seemed to be in and out of those stocks depending upon the news of the week (infection rates, vaccine progress, a build-up in consumer savings than might be spent on travel in 2021). That see-sawing is still happening in the sector as investors grapple with estimating demand and capacity utilization post-vaccine. The main problem with the travel sector is that it is driven by high volumes and low margins. Even if there is a slight drop in demand post-vaccine compared to things pre-Coronavirus, it could significantly jolt profitability.

**Chart 2:**

**Travel Sector Stocks Since the Market Bottom on March 23rd, 2020**




Source: Bloomberg Financial L.P. as of 15/9/2020

Again, investors that attempted to trade based on shifting headlines often saw prices reverse relatively quickly, testing the initial premise of the trade.

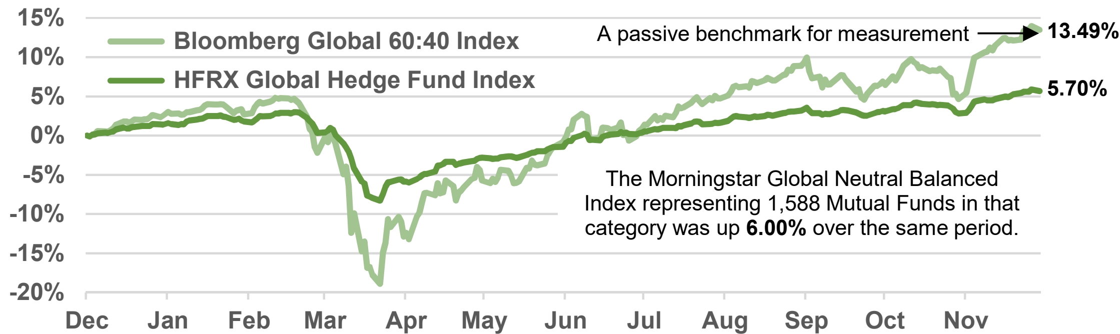
**Many hedge funds and mutual funds, which can have relatively high turnover rates, have lagged during the decline in March and the subsequent recovery.**

Hedge funds and mutual funds on average have had a difficult stretch over the last year, a period encompassing the Coronavirus selloff and subsequent recovery (**Chart 3**). Our approach tends to be more focused on capturing long-cycle gains and matching the potential long-dated liabilities and spending plans that our clients may have. Were many hedge funds and mutual funds trying to outguess the markets with bold moves? It is hard to tell exactly. However, many of these products have been known to have relatively high turnover rates in normal years. Plus, their fees can be substantial which might create

some urgency to capture gains sooner than later.[1] It might have been the portfolio turnover resulting from this pursuit that set them back on the whole (or it could be that these funds just made bad decisions on average – which might be more of an indictment).

**Chart 3:**

## One-Year Return from December 1, 2019 to December 1, 2020




Source: Bloomberg Financial L.P. and Morningstar.ca as of 15/9/2020. Bloomberg US EQ:FI 60:40 Index is designed to measure cross-asset market performance in the US. The index rebalances monthly to 60% equities and 40% fixed income. The equity and fixed income allocation is represented by Bloomberg US Large Cap (B500T) and Bloomberg Barclays US Agg (LBUSTRUU) respectively. The HFRX Global Hedge Fund Index is designed to be representative of the overall composition of the hedge fund universe. Funds in the Global Neutral Balanced category must invest less than 70% of total assets in a combination of equity securities domiciled in Canada and Canadian dollar-denominated fixed income securities. In addition, they must invest greater than or equal to 40% but less than or equal to 60% of their total assets in equity securities.

We have tried not to second-guess things. Following a rebalancing of the model portfolios in mid-March, we have been happy with the way they looked in the midst of all the apparent turmoil. There were a number of headlines regarding the markets, the economy, sectors, and specific companies that got us thinking about making changes. But sober second thought led us to hold off. Often, our estimation was that the risks that followed the almost total uncertainty in March were somewhat visible, allowing us to attach a plausible probability to them. Our conclusions usually reflected our belief that the financial and mainstream media were overestimating the likelihood of bad outcomes with respect to the impact of the Coronavirus on companies and the economy in general. A similar pattern was also evident with respect to events before and after the U.S. presidential election in November. Despite an ironically heavier than average research workload, we just kept the sail out and the keel even, so to speak. Sometimes doing less in terms of transactions is still exhausting. But, as we near the end of 2020, the approach has yielded more than thought when the crisis was unfolding back in the Spring.

**In contrast, our investment style prompted us to stay invested and get out of the market's way in order to capture gains over the length of the period from the March lows. The results of this approach were very encouraging.**

[1] The "A" series units of Canada's largest mutual fund, the RBC Select Balance Portfolio, has a management expense ratio, or MER, of 1.94%, source: Morningstar, Inc. Larger funds have more economies of scale which has the effect of reducing the percentage fee. With respect to hedge funds, a study of 1,490 of them in the U.S. found that in 2016 they had an average management fee of 1.49% plus an average performance fee of 1.17% for a total average fee of 2.66%, source: Ben-David Itzhak, Justin Birru & Andrea Rossi, "The Performance of Hedge Fund Performance Fees." The Ohio State University, Fisher College of Business Working Paper Series, June 24, 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 in November.

However, it looks like there will be a few changes this month as we are planning a rebalancing of all client portfolios. Some of the investments have done especially well and, as a result, they have become a larger percentage of the portfolio. It may be time to take some gains and reduce those overexposed positions as risk-management is a priority with us.

While there is always a possibility of a psychological selloff in the markets (currently stocks are somewhat overvalued in historical terms which could set off the herd), there are no visible significant concerns on the short-term horizon. Currently, it feels as though the market considers news regarding Coronavirus infections and U.S. political drama with the transition to a new administration as background noise. Focus appears to be on the

**No changes in the investments or the overall asset allocations in the model portfolios during November.**

**Some investment positions likely warrant be trimmed soon as the best performers are becoming an excessively large percentage of the model portfolios.**

[2] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 15/9/2020. 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.

period beyond unless there is an unforeseen economically consequential event in the short-term.

Governments and central banks have continued to communicate their commitment to providing aid and to stimulating the economy. Plus, they continue to face minimal political opposition. The market often likes the sugar-high that this can provide. However, this will become harder to justify once the vaccines are applied to larger percentages of the population.

Looking back, all of the asset classes that we use in the construction of the model portfolios are now in positive territory over the last 12-months (**Chart 4**).[3] As mentioned above, there is likely some overvaluation in the market, but this might be concentrated in highly visible growth stocks and stocks associated with some of the particularly spectacular speculative frenzies. "Value" stocks have been a driver of performance since the beginning of November as more investors rotate out of the growth names. The model portfolios have a "value" tilt, so hopefully will capture further benefits of that rotation if it does continue.

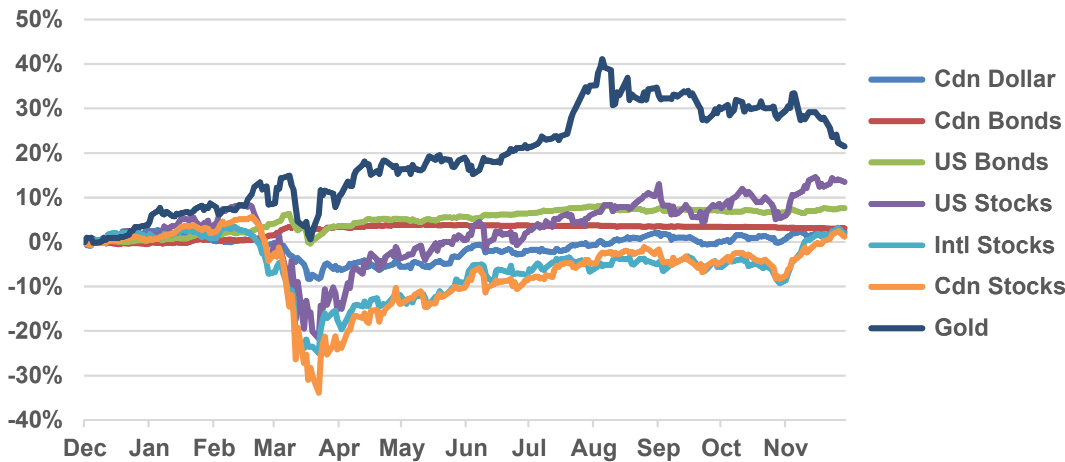
**Governments remain committed to stimulus which can provide investment markets with a sugar-high.**

**All the asset classes used in the model portfolios are higher since the beginning of December last year.**

**We might see a continuation of the rotation from growth into value and safety that began in early November.**

**Chart 4:**

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




Source: Bloomberg Finance L.P. from 12/1/2019 to 11/30/2020

[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 December 15, 2020.

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