TD Wealth

The Charter Group Monthly Letter

February 2021

Issue 74

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

Economic & Market Update

Gamification

I was watching the Global BC evening newscast recently and a story near the top of the program featured the stock market frenzy involving a herd of social-media-fueled day traders (mostly from the site Reddit.com) attempting to put a squeeze on hedge funds with short positions on the stocks of struggling companies.

Investing versus gaming: sometimes it is not easy to tell them apart.

A "short" position is one where an investor borrows shares from an investment dealer and then sells those shares hoping that they will decline. If they do, the shares are purchased back, locking in a profit. However, if the shares rise, the dealer will require the investor to post more capital to make sure the account has the required minimum amount of margin. If the shares continue to rise further, more capital needs to be deposited. This could eventually become a big problem for the investor and the position might have to be closed out at a big loss if it's not possible to muster up the additional capital. At this point, the

investor has been "squeezed out" of their position.

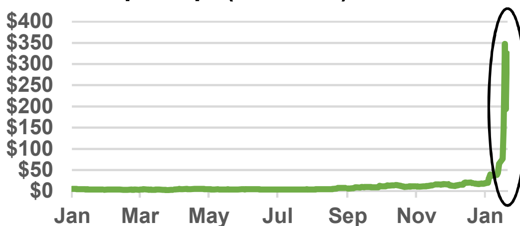
Wall Street lore and Hollywood movies have romanticized the notion of a deliberate "short squeeze" involving investors who are determined to push up a stock price in order to punish the short seller.[1] So, in some respects, what is happening now isn't entirely new.

However, a few of the aspects that may be powering the latest phenomenon are relatively new.

Many people are stuck at home. Many are receiving cheques from the government. Many are bored. Most can't travel. Plus, social media has evolved over the last decade to the point where millions of people can quickly coordinate on on-line (much more potent than relying on shoeshine boys or taxi drivers to spread investment rumours!).

The gaming of stocks is not new. However, some of the factors driving the recent frenzy are relatively new.

Chart 1:
GameStop Corp. (GME-US)



Source: Bloomberg Finance L.P. as of 2/1/2021

Chart 2:
Tootsie Roll Industries (RE-US)

Source: Bloomberg Finance L.P. as of 2/1/2021

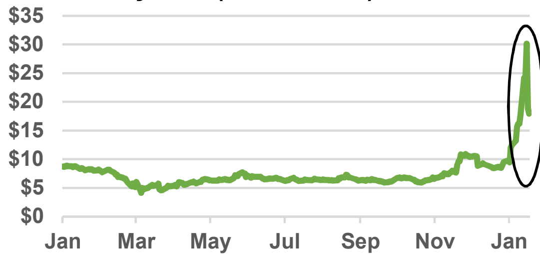
Looking at the price action of the main stocks affected, the social media herd appeared to come out of nowhere (**Charts 1,2,3,4**). But there has been some indication that these work-from-home investors have been moving through the markets since the spring of last year. Back then, investors were piling into the shares of bankrupt companies (Hertz being the most prominent example). Then in October, it was Bitcoin. Now their focus is on GameStop, Tootsie Roll, Blackberry, and Blockbuster Video, struggling or bankrupt firms with heavy "short interest" from hedge funds betting on price declines. Perhaps as the herd moves into less liquid investments, their impact has been more pronounced to the extent that it is now being talked about on the evening news.

The current phenomenon involves retail day-traders trying to squeeze out hedge funds that were betting on the demise of companies.

[1] My favourite depiction of something similar is from the 1983 movie *Trading Places*, starring Eddie Murphy and Dan Ackroyd. However, in that movie, the Duke brothers (Mortimer and Randolph) went bankrupt when they couldn't meet the margin required on their long position in orange juice futures. The futures market traditionally involves the heavy use of margin on both short *and* long positions. As a result, there could be a "long squeeze" on someone who is trying to corner the market. The movie was loosely based on the attempt by the Hunt brothers of Texas to corner the silver market in 1980.

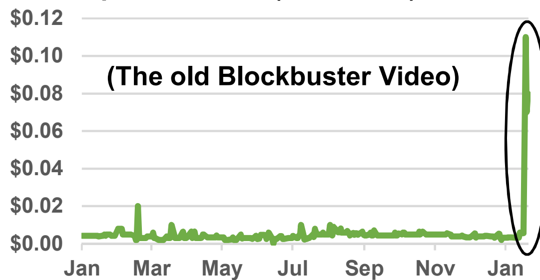
Low margin interest costs, near-zero commissions, trapped at home, an abundance of free time, a good recent decade of returns may have helped entice retail investors to take chances.

Chart 3:
Blackberry Ltd. (BB-Canada)



Source: Bloomberg Finance L.P. as of 2/1/2021

Chart 4:
BB Lliquidation Inc. (BLIAQ-US)



Source: Bloomberg Finance L.P. as of 2/1/2021

Very low or zero commissions, free money, cheap credit, and free time have had an impact on retail investors in general (beyond the social media herd). TV commercials that have little or no grounding in the realities involving risk and return and aimed at these investors are proliferating. One features a couple of employees in an office kitchen gushing about an Iron Butterfly Spread, an options strategy that they imply they learned as part of the investor education offered by their online trading provider. I first learned of the strategy as part of my options licensing exam in 1990. In 30 years, and with the benefit of a Bloomberg Terminal, I have never used such a strategy or anything like it. Analyzing the payoff probabilities of these strategies is a sobering exercise and contrasts against the enthusiasm expressed by investors who dabble in this area.[2]

Another series of other commercials involve the dream of quick home ownership intertwined with investing. In one, two young men are shown in a high-rise condo unit. One asks the other how he was able to buy the place. The reply was that it was as easy as opening an investment account. Really?

With the social media herd along with general retail investors succumbing to the seduction of quick payoffs, are these signs of a market bubble such as the one that we witnessed just before the Dot-com crash in 2000? Some of the recent frenzies are reminiscent of the headlines during the internet bubble. However, back then stock markets were in a very different state relative to long-term cycles.

A secular bull market in stocks, using the Dow Jones Industrial Average (the Dow), began on August 12, 1982 and topped out on January 14, 2000, rising 1,409%, equating to a 16.84% compounded growth rate per year. Since January 14, 2000 until now, the Dow is

[2] Odd-lot options trading volume (odd-lots are common with smaller retail investors) has grown significantly over the last year to record levels. See: "Why everyone is now an options trader," *The Economist*, January 16, 2021.

only up 156%, equating to a 4.59% annual compounded rate (**Charts 5&6**). Although the last decade has been generally positive, when averaged into the last 20 years, returns are modest. The returns since 2000 have been more indicative of a secular bear market, albeit with a few policy-driven cyclical bull markets tossed into the period.

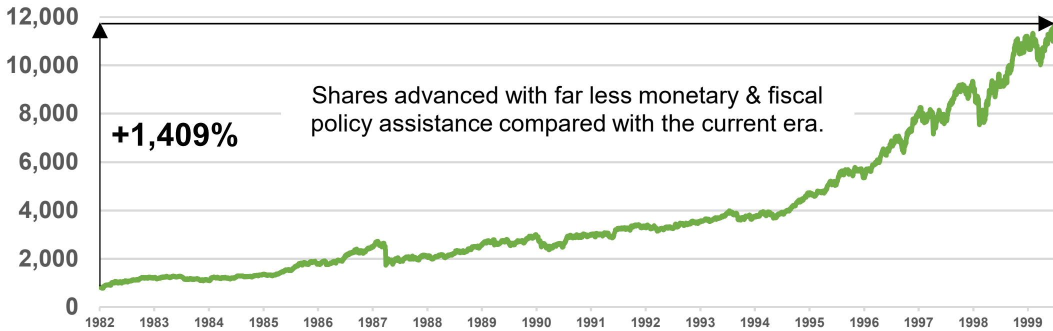
Is this speculative frenzy a sign of a market-top?

Comparisons with the early 2000 market-top may not be that helpful.

2000 was the end of a prolific 18-year secular bull market and speculation was much more widespread.

Chart 5:

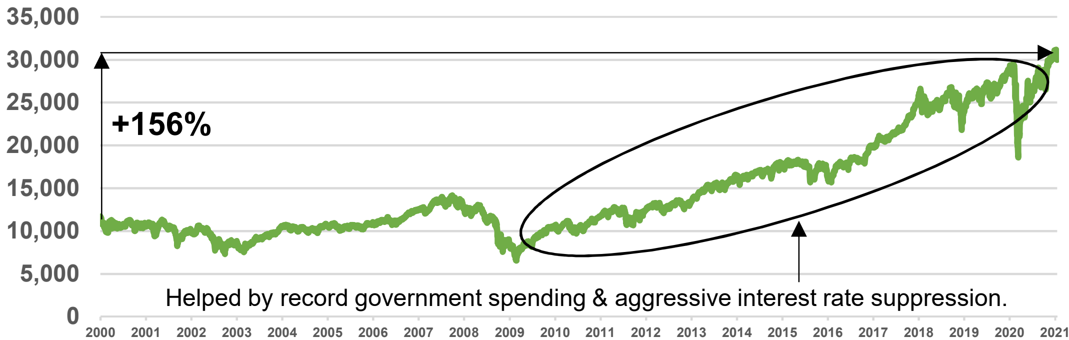
Dow Jones Industrials Average: August 12, 1982 to January 14, 2000



Source: Bloomberg Finance L.P. as of 2/1/2021

Chart 6:

Dow Jones Industrials Average: January 14, 2000 to February 1, 2021



Source: Bloomberg Finance L.P. as of 2/1/2021

The current situation looks more like localized bubbles in certain areas of the markets. It will be interesting to observe what happens when things get back to normal post-pandemic. No government cheques, people free to travel, and more work back at the office. The Reddit.com echo-chambers may lose their appeal and the social media investment herd might recede back to its normal size.

Although it can be hard not to pay attention to the games played by day-traders, investors should be more concerned about things like the continuation of supportive government economic policies.

Although stock prices are somewhat pricey relative to their fundamentals in general, there is a lack of market-wide speculative fever. As opposed to focusing too much on local bubbles, the market should be more concerned with the continuation of low interest rates associated easy monetary policies and the high level of government spending. If those factors change, investors might find real reasons for an overall correction.

Model Portfolio Update[3]

The Charter Group Balanced Portfolio
(A Pension-Style Portfolio)

	Target Allocation %	Change
Equities:		
Canadian Equities	12.0	None
U.S. Equities	38.0	None
International Equities	8.0	None
Fixed Income:		
Canadian Bonds	22.0	None
U.S. Bonds	6.0	None
Alternative Investments:		
Gold	8.0	None
Silver	1.0	None
Commodities & Agriculture	3.0	None
Cash	2.0	None

No changes were made to either the individual securities or the overall asset allocations in the model portfolios during January.

No changes to the model portfolios during January.

Just some quick comments regarding positions added in December. There have been some discussions about silver bullion in the social media. Since we added the bullion in the form of the iShares Silver Trust ETF in mid-December, silver is up a little over 20%.[4] We are investing in silver as an inflation hedge and for its industrial demand in a recovery (being an input into the manufacturing of solar panels might also provide some upside). However, because it is a global commodity, retail investors might find it hard to have a sustained impact. Plus, there is an old saying regarding precious metals: "The cure for high prices is high prices." Higher prices can bring out supply that was effectively hidden from the market (small bars and coins in safety deposit boxes, jewelry, dental scrap, etc.) which places some downward pressure on the price.

The social media day-trader herd is bidding up silver which we added in December. But we're not getting excited about that.

[3] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 2/1/2021. 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.
[4] Source: Bloomberg Finance L.P. as of 2/1/2021.

Also, in mid-December, we removed the iShares S&P 500 Growth ETF. Partially, this was to tilt the overall model portfolio towards companies whose share prices better reflect their financial statement fundamentals in our opinion. However, we also wanted to avoid the impact involving the addition of Tesla Inc. to the S&P 500 Growth Sub-Index which occurred on December 21. There is always a chance that Tesla continues its torrid price trajectory, but we believe the probability is waning. Our major concern was how the stock might affect the overall S&P 500 Index and its Growth Sub-Index given the stock's astronomical market value weight. Also, it would not be a stock that we would hold outright with our pension-style approach to investing as does not pay dividends and is still in the mode of seeking significant financing (with three new share issues in the last 12 months).

We removed the iShares S&P 500 Growth Index partially because of the announced addition of Tesla to that index.

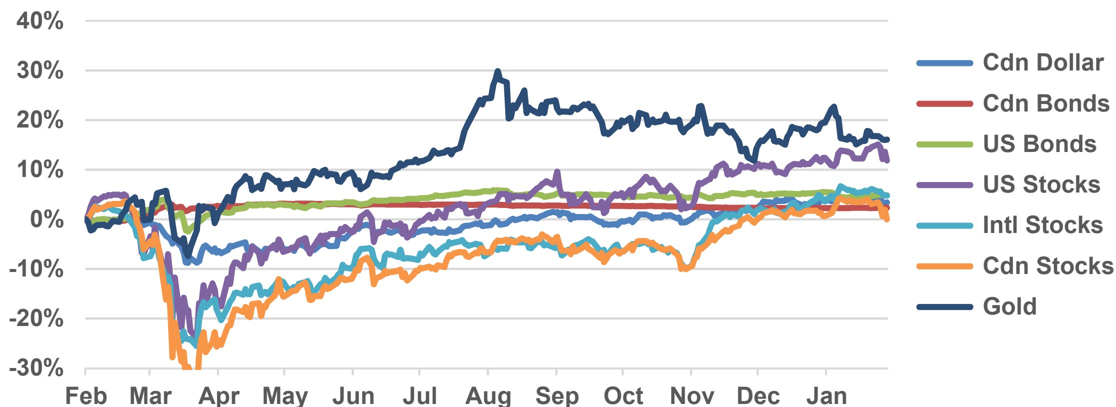
With respect to prospects for the markets in general, we may be in for more of "Don't fight the Fed".[5] And to extend that saying a little further: don't fight the Fed while the Fed is fighting a pandemic. Extremely accommodative monetary policy and profligate fiscal policy look to continue if we believe the policymakers. Inflation or a bond market revolt are about the only two impediments out there and they don't appear very imminent. We could always get one or two garden-variety market corrections this year, but if the spending and liquidity spigots stay wide open, those may be somewhat temporary.

As the impact of the pandemic continues to roll on, there appears to be very little pushback against market-friendly government policies.

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 7**).[6]

Chart 7:

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



Source: Bloomberg Finance L.P. from 2/1/2020 to 1/31/2021

---

[5] A phrase attributed to author and investor Martin Zweig, with "Fed" referring to the U.S. Federal Reserve Board.
[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 & Monetary 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.

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 February 1, 2021.

The information contained herein has been provided by Mark Jasayko, Portfolio Manager and Investment Advisor, TD Wealth Private Investment Advice, 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 trademarks are the property of The Toronto-Dominion Bank and its subsidiaries.