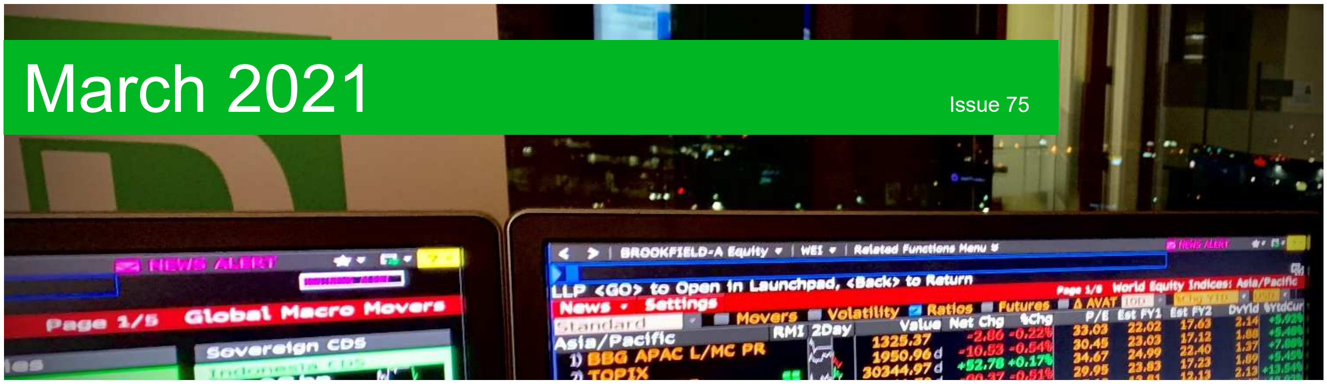
TD Wealth

The Charter Group Monthly Letter



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Economic & Market Update

Space Money

The recent price increase of bitcoin has been significant enough for the financial and general media to place it back on centre stage. It is now a daily discussion topic for us as our investors are looking for answers as to why it is skyrocketing again. So, how much has the cryptocurrency's story changed since it made its last notable spike in price? Hint: not much.

Before exploring potential reasons for the price increase, let's try to define what bitcoin is and what it is not (Remember, this is not authoritative, only my own interpretations).

It is a digital token. It has a widely and continually quoted price, usually in U.S. dollars. Its maximum supply will be limited to 21 million bitcoin. There are currently 18.64 million bitcoin.[1] They are highly divisible: a "satoshi" = 1/100,000,00 bitcoin. A bitcoin is created,

Bitcoin is in the news again … because it is going up.

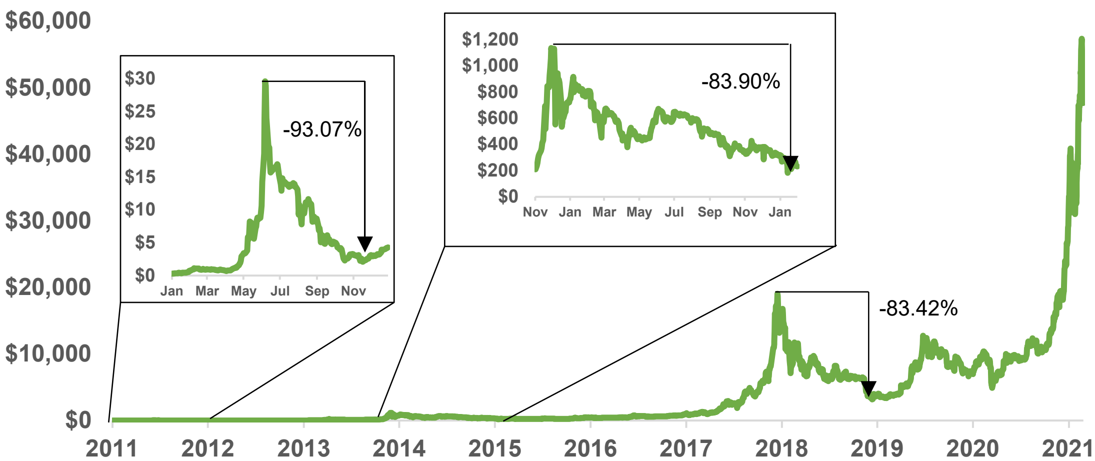
However, bitcoin today is still the same bitcoin over three years ago when it was first written about in this newsletter.

The debate is mostly about whether someone will pay a higher price in the future compared to today.

[1] Source: YCharts Inc. as of 2/25/2021

or "mined" virtually when a computer that is helping to verify bitcoin transactions reaches a preset amount of work and is then rewarded with a chance to win a bitcoin by guessing the answer, against astronomical odds, to a predetermined puzzle. This convoluted process was designed beforehand to govern the rate of bitcoin production, and it appears to have worked well. There are no short cuts and there is a clear roadmap for those who would like to buy the computing power in order to potentially create bitcoin.

Chart 1:
Bitcoin/U.S. Dollar Cross Rate



Source: Bloomberg Finance L.P. as of 3/5/2021

Some aspects of what bitcoin is and what it is not make it difficult to embrace the promise that some proponents see in its future.

That's basically what it is. What is it not? It is not a coin. It is not a currency. It is not legal tender (if something that is not legal tender is used to settle a debt, that debt may in fact not be settled). It is not an investment security and it can't be held outright by a trust company or in an account at a financial institution. Instead, it is owned by whoever holds, or knows, the security key to a digital wallet. The holder, or "bearer", of the security key owns the bitcoin, no other identification is needed.[2]

Apart from these attributes, advocates of bitcoin often highlight some very contestable virtues to justify its rising price.

Is it the "new" gold?

Will it be an accepted system for payments?

Proponents have suggested that bitcoin is the new "gold" as it is also something that has limitations on supply which might help provide a hedge against currency devaluation or inflation. Since governments can't control (or expand) the bitcoin supply, the hope is that

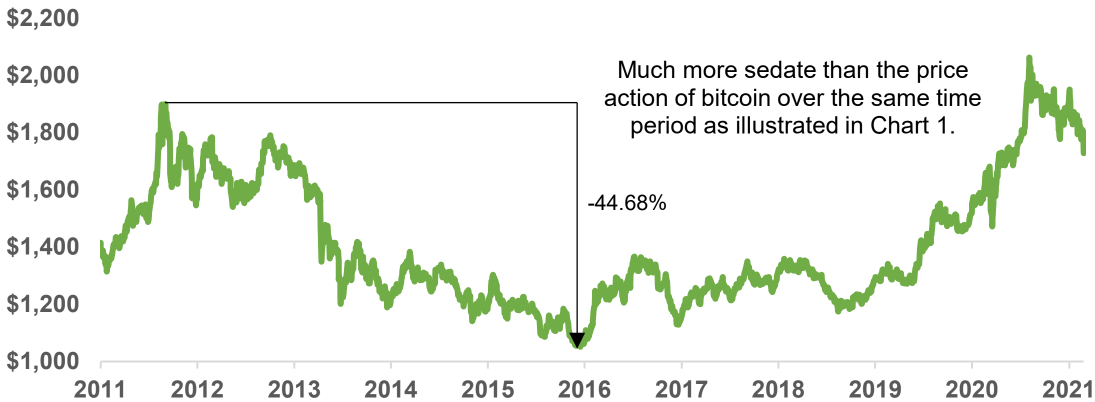
[2] Bonds in "bearer" form, which were common when I first entered the investment industry, have almost disappeared from the landscape. Because there was no registration or identification of the investor, they featured prominently in nefarious activities. This led governments to introduce legislation that would severely discourage their use. Beginning in 1982, the U.S. started to disallow the tax deductibility of interest paid on the bonds by the issuers. Also, the last series of bearer bonds issued by the U.S. Treasury department matured in May 2016.

one will be immune from accommodative monetary and fiscal policies that might erode purchasing power.

There has also been the hope that bitcoin could be used as a payment platform.[3] That said, contactless payments using credit cards or phones have become even more convenient over the last few years (and especially important during the pandemic).[4]

Chart 2:

One Ounce of Gold/U.S. Dollar Cross Rate



Source: Bloomberg Finance L.P. as of 3/5/2021

So, does any of this justify the current price of bitcoin in U.S. dollars? Unfortunately, I have absolutely no idea. Compared to a stock or a bond, where there is almost an endless number of factors potentially driving the price (products, services, consumer trends, competitors, income, assets, government regulations, etc., etc.), bitcoin is far less dimensional. There are a couple of debates about attributes (and not very convincing ones to me as mentioned above). But mostly, it is debate about where the price is going to go. There isn't much diversity of opinion because there is not much on which to have an opinion. This is reminiscent of the mania involving tulip bulbs in 17th century Amsterdam. Aside from producing a beautiful flower, traders were really only debating whether they could sell it for a price higher than they bought it. And, for a while, prices increased dramatically.

Apart from some the stretched reasoning regarding its future potential, current trading appears be merely a debate about where the price is going to go.

There just isn't much hard or objective evidence to debate.

The price of bitcoin can go anywhere crowd psychology able to drive it. We may not know where it is going, but we do know where it has been (**Chart 1**).

[3] In the Spring of 2017, I successfully used bitcoin to directly pay for a coffee at Waves Coffee House at Pender & Main in Chinatown. Because of the effort involved and not being totally sure how much the coffee was actually costing me in Canadian dollars, I have not used bitcoin to purchase anything else since then.

[4] The Apple Pay app on my iPhone, which is linked to my TD credit card, is used for almost all my credit card transactions. Super convenient and, admittedly, kind of fun!

As mentioned above, one of the more forceful arguments of bitcoin proponents is the claim that it is much like gold in terms of its ability to offer some hedging against paper currency devaluation They also argue that it is a viable "store of value" similar to gold. As a result, one might expect the price of bitcoin and gold to be highly correlated. However, since the inception of bitcoin on January 3, 2009, there is almost no monthly correlation to the price of gold. The monthly correlation coefficient between bitcoin and gold in U.S. dollars is 0.009.[5] Perfect "positive" correlation would be 1.000, whereas perfect "inverse" correlation would be -1.000. And, no correlation would have a coefficient of 0.000. The bitcoin/gold price relationship appears to be statistically random.

Is bitcoin like gold?

The lack of correlation between the price of bitcoin and gold over the last decade suggests that they are two different things.

Also, looking at peak-to-trough-to-peak price movements might provide us with how well gold and bitcoin act as relatively stable stores of value (less volatility might provide a holder with more confidence that they will be able to afford a good or service when they need to cash in). As we can see in **Charts 1 & 2**, bitcoin is much more prone to significant swings upwards and downwards over much shorter time periods.

That's the story that the past tells us. Looking to the future, there could be a few more hurdles for bitcoin. By some estimates, the mining of bitcoin produces a carbon footprint comparable to New Zealand because of the energy consumption involved.[6] This could continue after the last bitcoin has been mined as the verification of bitcoin transactions on the blockchain requires similar computational intensity. Will bitcoin be able to thrive in a world where climate impact is given increasing importance?

How will bitcoin be able to navigate future potential challenges?

It is not very "green" with respect to the environment.

Governments may want to tax the gains from holding it.

Governments may lose patience and outlaw its use if they see bitcoin challenging their monetary sovereignty.

And, what about governments? Will they remain silent while bitcoin miners capture seigniorage (the different between the value of something and the cost to product it) which has been the domain of sovereign governments for millennia? (The higher the price, the greater the seigniorage) Will they tax bitcoin?[7] Will courts enforce agreements that use bitcoin despite it not being legal tender?

It will be interesting to see if there is anything new about bitcoin the next time its price makes news. Or, will it just be the same thing it has mostly been: A proposed solution in search of a problem.

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[5] Source: Bloomberg Finance L.P. as of 3/5/2021.
[6] Ryan Browne, "Bitcoin's wild ride renews worries about its massive carbon footprint." CNBC News, February 5, 2021.
[7] The U.S. Internal Revenue Service 2020 Individual Income Tax Return, Form 1040, now has a Yes-or-No checkbox with the question: "At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in a virtual currency?"

Model Portfolio Update[8]

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 February.

Stock markets around the world continued to do well in February. The promises to keep economic stimulus gushing continued to be the elixir. As discussed during our WebEx seminar on February 17th, I feel that governments and central banks will continue to create or borrow money and spend as much of that money as they can, until they can't anymore. Inflation, or a major bond market revolt might put an end to it. Despite there being some inflation chatter during the month, and despite a minor revolt when the U.S. Treasury auctioned 7-year notes on February 25th, the reassurances provided by the U.S. Federal Reserve about maintaining their easy-money policy was enough to counter most potential anxieties, for now.

No changes to the model portfolios during February.

Governments and central banks are still committed to stimulating economies around the world.

As long as they do so, this can provide a tailwind for stocks.

[8] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 3/1/2021. 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.

The Canadian dollar strengthened along with other commodity-based currencies on the notion that a recovery could increase demand for commodities.

The Canadian dollar was stronger versus the U.S. dollar during the month which trimmed the contribution from the gains in the U.S. holdings. The Canadian dollar increase was likely influenced by the on-going "reflation trade" where investors are rotating into stocks and into currencies perceived to get an upward bump when people rush back towards normalcy once lockdowns are lifted. Companies with excess and ready capacity, and countries that are commodity exporters, have been the beneficiaries so far.

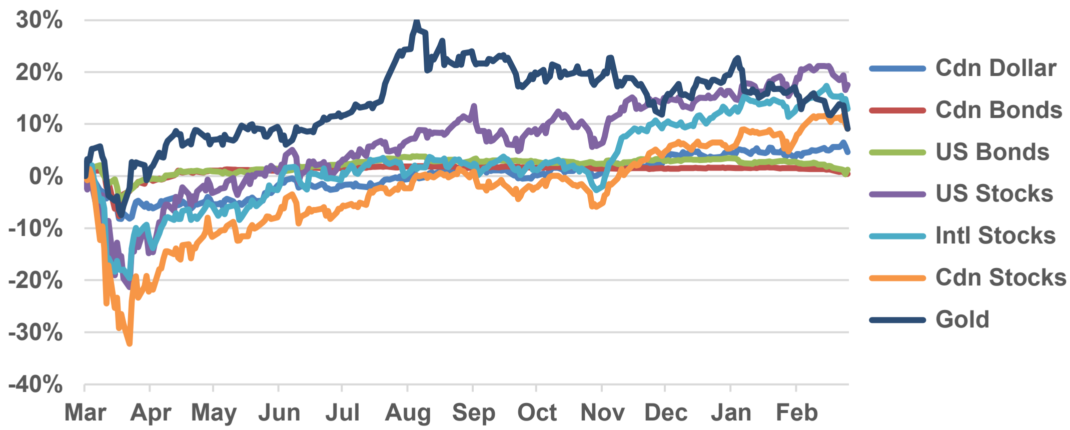
Gold was lower during the month as there is still ebb and flow in the debate regarding inflation resulting from pent-up demand during a recovery.

In contrast, gold was lower during the month, continuing its lagging performance that began in early autumn. It could be that we are seeing a tug-o-war between those who think the inflationary effects of the reopening will be transitory versus those who think that they will be more sustained. Regardless, be prepared to see a tsunami of headlines over the next six months regarding the pace of reopening and the predicted impacts. We could see more speculation because of the optimism. But, giving the constantly shifting terrain, any overconfidence could be punished if those speculators don't get things mostly right.

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 3**).[9]

Chart 3:

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



Source: Bloomberg Finance L.P. from 3/1/2020 to 2/28/2021

[9] 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[10]

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

[10] 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 March 5, 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.

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