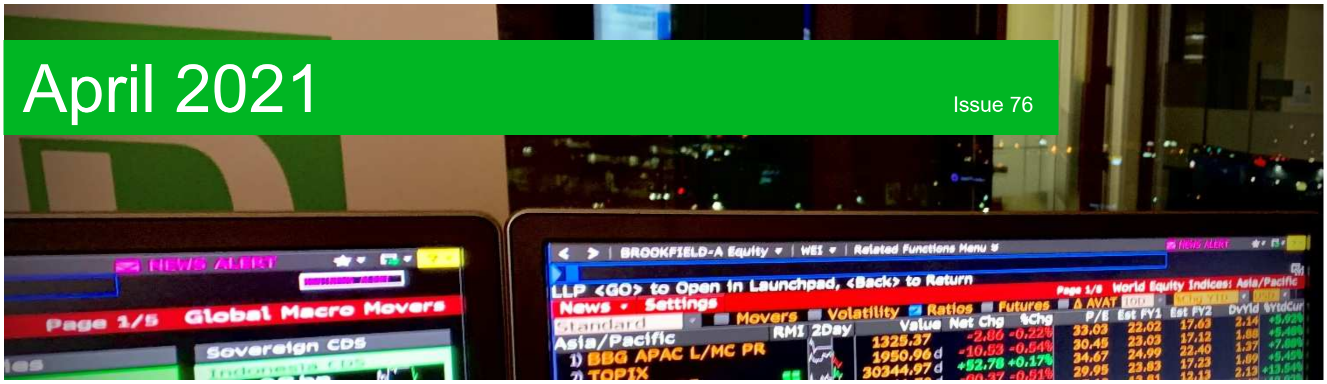
The Charter Group Monthly Letter

April 2021

Issue 76



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

Economic & Market Update

Infraspenditure

As interest rates have declined over the past four decades (**Chart 1**), governments have been inclined to increase spending. After all, lower interest rates make it cheaper to borrow in order to finance that spending.

In the late 1970s, and into the early 1980s, policymakers were somewhat tentative in advocating deficit spending, although it ended up happening anyway. It was an era when inflation caused substantial pain for consumers. However, by the mid-1980s, inflation rates become subdued enough for governments to test the debt markets. Then, by the late 1980s, the U.S. Federal Reserve Board signaled through their actions that they had become very accommodative, choosing to cut interest rates during market crashes (beginning with Black Monday in October 1987) and pre-emptively cutting rates when fearing an economic slowdown (the first occurrence in 1989).

Voters tend to vote for spending …

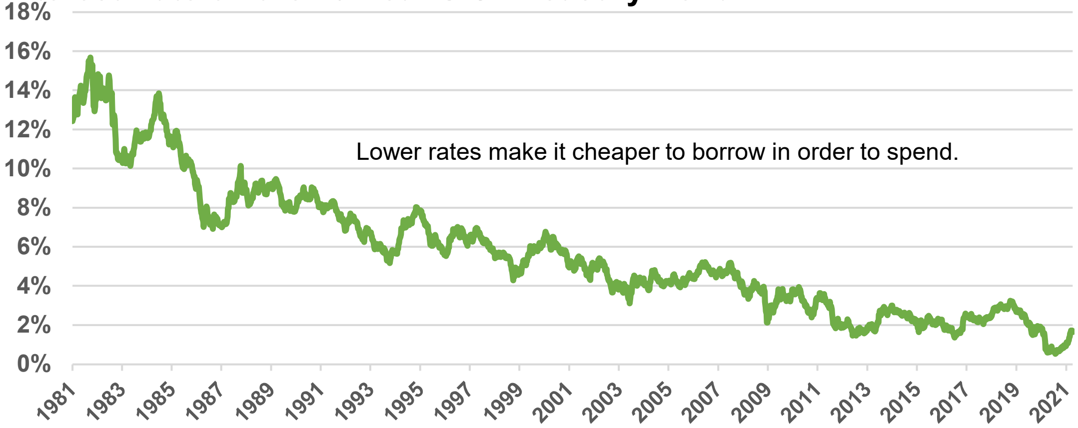
Low interest rates facilitate spending …

Vibrant democracies tend to embrace promises that require spending …

So, don't be too surprised by increasingly massive amounts of spending.

Chart 1:

Interest Rate on the 10-Year U.S. Treasury Bond



Source: Bloomberg Finance L.P. as of 4/8/2021

Lower interest rates have encouraged a massive expansion in government borrowing.

The only aspect of change has been the rate of spending increases.

Both the major political parties in the U.S. have embraced "borrowing to spend."

With the exception of the U.S. budget surplus "era" between from 1999 to 2001, and the times when borrowing levels hit legislated debt ceilings before they were politically renegotiated, the U.S. federal debt outstanding has increased steadily since the 1980s.

I should note that increasing debt levels have mostly gotten bipartisan endorsement. Occasionally there have been politicians who have splintered away from their parties and voiced opposition (the Tea Party would be the most recent example).

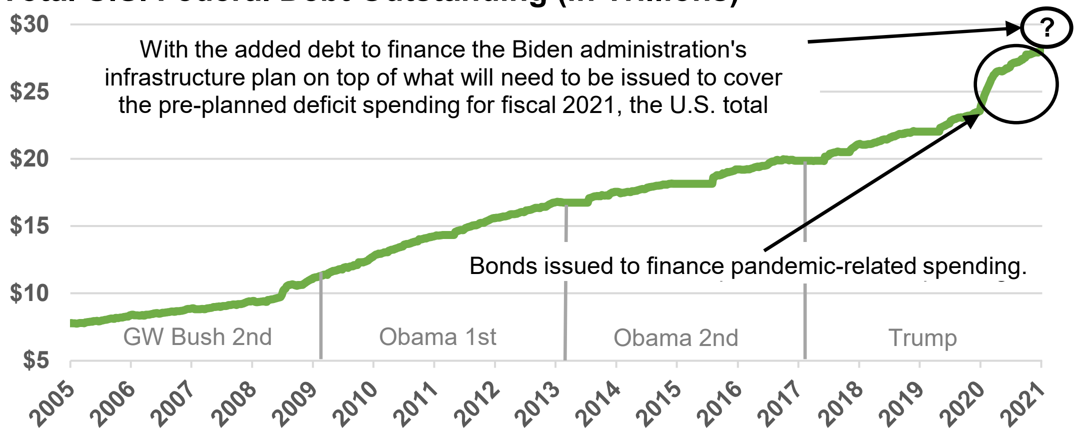
The first term of the Obama administration saw an acceleration in the rates of borrowing and spending (**Chart 2**). Much of the spending was to counteract the economic contraction caused by the sub-prime mortgage crisis. Inflationary pressures were likely dampened by the fall in demand for goods and services during the recession. It is hard for prices to rise when demand is weak.

Although spending increased during the second Obama term, the rate of spending increases was about half of what it was in the first term (**Chart 2**).

With the Republicans winning the White House in 2016, one might have expected the party associated with fiscal conservatism would produce falling budget deficits. Instead, the spending increases during the Trump administration resembled the first term on the Obama administration (**Chart 2**) (and this was before the pandemic-related spending towards the end of the Trump administration).

And now, despite the increase in spending during the Trump administration, and despite the incredible acceleration in spending during the last nine months of Trump's presidency, the Biden administration, which is still in its first 100 days, has proposed a *further* acceleration in spending.

Chart 2:
Total U.S. Federal Debt Outstanding (in Trillions)



Source: Bloomberg Finance L.P. as of 4/8/2021

The Biden administration has already followed through on a $1.9 trillion COVID relief package that mostly involved sending $1,400 cheques to individual Americans in March. Some Democrats in the U.S. Congress have suggested doing this again a few more times although there is probably not enough political support for it due to the eye-bleeding costs of doing so.

However, in addition to the $1.9 trillion relief package, the Biden administration been prominently advocating legislation that would approve up to $2.3 trillion in infrastructure spending.[1] There is a general sense that the U.S. needs an infrastructure upgrade as evidenced by crumbling bridges, worn-out freeways, and aging airports. There is much agreement between Democrats and Republicans on this. However, the Biden administration's plan also directs spending towards things such as green energy initiatives and partisan projects (it is common in U.S. federal legislation to tack on all sorts of things to spending bills – both parties do it).

The recently announced Biden administration infrastructure plan will potentially shift spending into overdrive.

Although the long-term return on investment in the form of enhancing economic growth is a legitimate expectation of real infrastructure spending, the return on investment related to government partisan-influenced projects is highly suspect. An illustrative case during

[1] Andrew Restuccia and Tarini Parti, "Biden's $2.3 Trillion Infrastructure Plan Takes Broad Aim." *The Wall Street Journal,* March 31, 2021.

the Obama administration was the loss of a $535 million loan guarantee to a solar panel company named Solyndra.[2] It would be reasonable to categorize that type of spending mostly as a handout and to expect that its economic benefit might be contained to the short-term. That portion of the spending may not provide the longer-term economic growth that could then be taxed in the future and used to pay down the original spending. Instead, it merely tends to add further to the growth in debt used to finance the spending.

Some of the goals of the infrastructure package are vital to the long-term growth potential of the U.S.

However, within the spending bill, there some dubious expenditures that may not provide much return on investment.

The magnitude and composition of Biden's proposed infrastructure spending legislation was not known until recently. As a result, its potential impact is suddenly stacked on top of all the existing concerns over spending, much like all the previous pandemic-related spending that was also stacked on top of the concerns that existed from the Trump administration spending up until the outbreak. Markets are still digesting the size of the infrastructure plan and its potential economic and financial market ramifications. As covered in previous issues of *The Charter Group Monthly Letter*, there is only so much appetite for government bonds. The primary way of enticing investors to buy more bonds when they already have enough is to offer a higher interest rate. However, this often has the effect of raising interest rates for all borrowers, not just the government.

There is also a growing contingent of investors questioning the need for yet more stimulus, whether it is cheques in the mail or infrastructure spending. Consensus expectations are for a robust bounce-back in the economy as pent-up consumer demand is unleashed. Borrowing to finance more spending when demand is already increasing could ignite some of those inflationary forces that the bond markets were worried about last month.

There is a chance that the size of the infrastructure package could be trimmed back. There are some Democrats in Congress who represent more conservative areas of the country and don't want to be tagged as big spenders when they run for re-election. Senator Joe Manchin of West Virginia is the de facto leader of this group. However, we are still talking trillions here and a minor reduction is not going to change U.S. fiscal policy that much.

The bond market is already flooded with supply. What will happen when more bonds are issued to finance the infrastructure spending?

By the summer, we should get a better idea of the total cost of the infrastructure package and what the U.S. debt situation will look like over the next year or so when adding the already expected budget deficit to the total. At that point, it will be interesting to see if there is a bond market reaction.

[2] Katie Fehrenbacher, "Why the Solyndra mistake is still important to remember." *Fortune Magazine*, August 27, 2015.

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

There were no changes to the asset allocations of our model portfolios or the individual security holdings during March.

No changes to the model portfolios during March.

Stocks mostly continued their climb, the most recent stretch starting in November when it appeared that the vaccines were imminent. The Canadian equities were the star over the month as investors were attracted to the commodity component of the Canadian economy. As global economies spike upwards during a return to normality, there are expectations that commodities will be in demand. The S&P/TSX Composite Index was up 4.56% over March which helped the model portfolios.

Stock markets continued to do well.

Canada did especially well with an increase in demand for commodities.

Outside the emerging markets (to which we have no exposure), other developed markets mostly did well on the reopening/reflation "trade" which also helped to provide some tailwind for the model portfolios.

[3] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 4/8/2021. 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.

There does not seem to be an appetite among voters and politicians in Canada or the U.S. with respect to scaling back the stimulus anytime soon. Although this can create an economic hangover at some point, in the near term it tends to be good for equities. As mentioned in previous issues of *The Charter Group Monthly Letter*, a potential roadblock to continued stimulus might involve a bond market revolt in the form of a failed government bond auction.

Global economies continue to get drenched with stimulus.

Barring a bond market revolt, that could continue for a while.

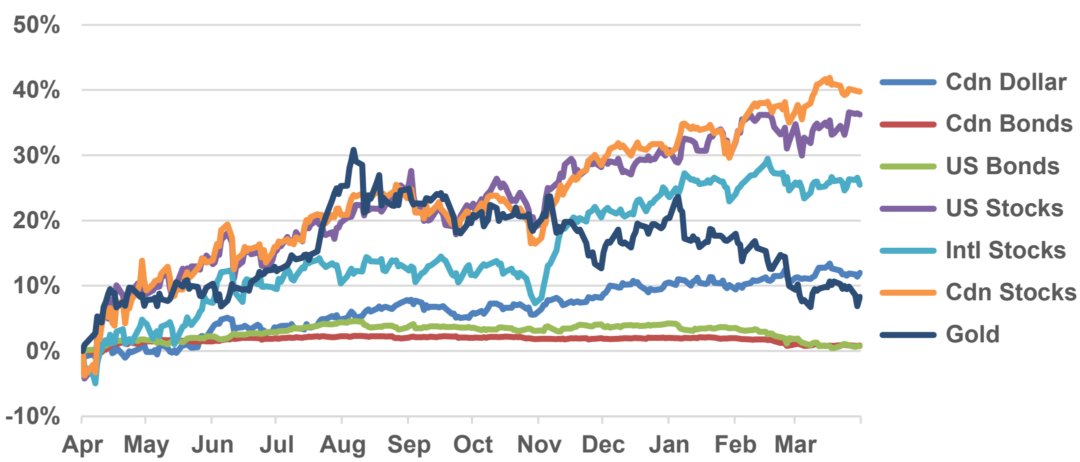
Canada is expected to unveil the first federal budget in two years on April 19. There could be some turbulence in the stock, bond, and currency markets if the deficit numbers are higher than expected. There may not be much scope to increase taxes in the short-term, especially with a potential election on the horizon. This could exacerbate the shortfall. The Canadian dollar could have a challenging time hanging on to all its gains over the last year as a result. We shall see.

An expected federal budget in Canada might reveal the heavy cost of stimulating the economy over the last year and could generate some market turbulence.

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**).[4]

Chart 3:

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



Source: Bloomberg Finance L.P. from 4/1/2020 to 3/31/2021

[4] 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[5]

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

[5] 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.