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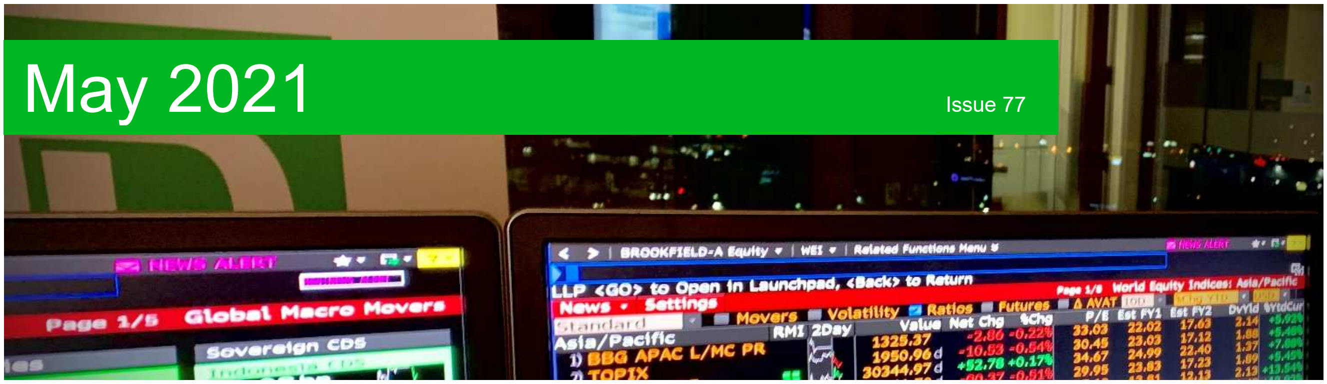

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Economic & Market Update

Budget Busters

More news on how massive the bill for pandemic-related spending will be.

Since last month's edition of *The Charter Group Monthly Letter*, which focused on the Biden administration's announcement of a $2.3 trillion infrastructure plan and its possible implications for investors, the president announced the "American Families Plan" which might cost up to $1.8 trillion. Since inauguration, it is the third major spending announcement (there was also the COVID relief plan costing $1.9 trillion). "A trillion here, a trillion there, and pretty soon you're talking real money."[1] Well, $6 trillion anyways.

So, everything I talked about in the April issue needs to be expanded by the amount of the "American Families Plan."

There was also a related announcement that focused on tax increases needed to pay for a portion of this additional spending. Before this news there was an assumption that some

[1] A quote attributed to a U.S. Senator, Everett Dirksen. However, he used "billion" instead of "trillion" in the quote. It was September 1969, and some inflation has occurred since then, both in terms of consumer prices as well as the dollar figures tossed around by government officials.

of the Trump-era corporate tax cuts would be reversed. However, a proposal to dramatically increase the capital gains tax surprised many observers.

The corporate taxation associated with further increased spending in the U.S. has dampened some of the enthusiasm for the U.S. dollar.

All this talk about further expanding spending and the accompanying taxation has had some impact on the price of the U.S. dollar relative to most of the other major currencies. Earlier on there was a sense that the U.S. would be somewhat parsimonious compared to other nations like Canada in terms of pandemic spending. After all, the U.S. has had a very successful vaccine rollout and a stunning increase in the consumer savings rate. However, there appears to be a legislative agenda aimed at taking advantage of the electorate's amenable stance towards additional spending in the waning days of the pandemic.

Proposed increases in personal capital gains taxes could impact the ability of companies to raise capital.

Companies in early growth phases can be especially dependent on access to capital.

For foreign capital seeking opportunity in the U.S., higher corporate and capital gains taxes make it a less attractive destination. Higher corporate income taxes reduce the free cash flows that companies are able to generate (and which are commonly used to value the stock of a company). Higher capital gains taxes can impair capital formation which can present funding problems (Tesla's balanced sheet growth, for example, is driven mostly by its ability to raise capital via secondary stock issues).[2] If there is more uncertainty regarding the ability to raise capital before a company can get to the self-funding stage, those foreign investors may look elsewhere.

Chart 1:

The U.S. Dollar Index (The DXY)

Source: Bloomberg Finance L.P. as of 5/7/2021. The Index measures the price of the U.S. dollar a basket of currencies including the Euro, the Japanese yen, the British pound, the Canadian dollar, the Swedish krona, and the Swiss france.

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[2] And, curiously, the second largest contributor to Tesla's balance sheet growth has been the selling of regulatory credits, which it receives from the U.S. federal government, to other carmakers.

Less foreign capital flowing into the U.S. usually translates to less demand for the U.S. dollar. Afterall, you can generally only buy U.S. investments with U.S. dollars. And, less demand for U.S. dollars tends to result in a lower price for the U.S. dollar vis-à-vis other currencies. Since the beginning of April, the U.S. dollar index (known as the DXY) has fallen 2.88% (**Chart 1**). From January 1 to the end of March, the DXY had gained partially on the hopes that the U.S. would be taking a more measured spending path.

I would conclude that the U.S. dollar has also been adversely impacted by the reluctance of the U.S. Federal Reserve Board (the Fed) to tighten credit conditions despite of some emerging signs of inflation. The Fed is arguing that the inflation will be "transitory" and does not warrant precautions for fear of tightening too much too early and choking off the nascent economic recovery.

Easy-money central bank policy has also been a headwind for the U.S. dollar.

The Canadian dollar, in addition to the other major global currencies, has, in turn, benefited from the decline of the U.S. dollar, especially over the last month (**Chart 2**). There has been some market analyst chatter about the potential emergence of a new commodity super-cycle, similar to what we experienced from 2000 to 2012. Commodity-exporting countries like Canada would stand to do well. However, the engine that drove the previous super-cycle was the People's Republic of China growing at a torrid pace following its inclusion into the World Trade Organization. Today, the P.R.C. is growing at about half the rate it was back then. The recent commodity price burst looks more like a supply-demand imbalance resulting from an expectation of a potentially robust economic recovery from last year's lows. However, once we approach normality, it is hard for me to imagine the supply-demand imbalance persisting for an extended stretch of time.

The U.S. dollar decline is expressed as a Canadian dollar gain in the exchange rate between the two currencies.

The Canadian dollar has also benefitted from a possible commodity super-cycle. But it may be too early to be confident in such a development.

Chart 2:

Canadian Dollar versus U.S. Dollar

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

The Canadian dollar has also found favour with currency traders following the Bank of Canada announcing its intention to scale back the rate at which it was purchasing bonds (an activity that has led to easier credit conditions in Canada over the last year). The news was heralded as a clear sign of exiting from stimulus.[3] Upon further review, it merely looks like an incremental tapering combined with a faint promise to raise rates in the 2nd half of 2022. Perhaps the Bank of Canada should be given some credit for being the first central bank to move, but let's not get carried away here.

The Bank of Canada surprised investors with suggestions of monetary tightening, the first major central bank to do so. Traders bid up the Canadian dollar in response.

The Canadian dollar still needs to deal with our own flood of spending to which the federal government committed when it released the budget on April 19th. Globally, we are one of the bigger spenders relative to the size of our economy, and that spending needs to be financed. Perhaps Canada will look at the Biden administration's capital gains tax hike with envy and imitate it. That may be a headwind for the Canadian dollar (as it has with the U.S. dollar), especially if other income tax increases are also contemplated.

However, just as taxation issues can be a drag on the U.S. dollar, we could see something similar in Canada if the government here is tempted.

However, tax increases are not going to be able to pay for the bulk of Canada's pandemic spending alone. Borrowing, and perhaps some money-printing, may be on the menu, both of which could temper the rise of the Canadian dollar relative to the U.S. dollar.

The next chapter in the "pandemic budgetary sagas" involve legislation in the U.S. The spending amounts might have to be reduced somewhat because of the slim Democrat majority in the U.S. Senate. There are some Democrats who were elected in more conservative states and who may be difficult to corral in order to vote for *all* the spending objectives and *all* the increased taxation. That may help the U.S. dollar.

U.S. spending has not been legislated yet.

Some moderate Democrats might ask for a reduction in spending.

Market strategists and traders are also beginning to look a little over the horizon to the Jackson Hole Symposium in late August, an annual confab which brings together central bankers and economic policymakers from around the world.[4] In the past it has been a platform from which big announcements are made. Some are speculating that if inflation doesn't look very "transitory" at that point, the Fed might surrender and reverse course, thereby lifting the U.S. dollar against most other currencies. Even a mere hint could cause an outsized reaction in stock, bond, commodity, and currency markets.

Central bankers from around the world will meet in August. Often this is a platform for big announcements. Analysts will be watching closely.

[3] Shelly Hagan, "Bank of Canada Becomes First to Signal Exit from Stimulus." Bloomberg News, April 21, 2021.
[4] Stephen Spratt & Edward Bolingbroke, "Traders Ramp Up Bets on a Hawkish Fed Surprise at Jackson Hole." Bloomberg News, May 7, 2021.

Model Portfolio Update[5]

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 April.

No changes in the model portfolios during April.

April saw all asset classes represented in the model portfolios moving higher. The promises of big spending, low interest rates, plus the vaccine progress, and generally lower infection rates all appeared to add buoyancy to markets.

All asset classes used in the model portfolios were higher over the month.

One of the bigger contributors to results was gold bullion. Out large targeted weighting helped to capture the bounce-back in gold after lagging since last August. Inflation concerns have shown up in the pricing of bonds, various commodities, and, arguably, some cryptocurrencies, but gold has mostly been left out of that party. However, inflation resulting from a potential demand/supply imbalance associated with the economic re-

Gold finally found some traction after lagging most other investments since last summer. Perhaps more investors are gravitating to its inflation-hedge potential.

[5] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 5/3/2021. 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.

opening has been a prominent headline over the last month. Perhaps investors have started to consider *more* hedging strategies, including gold.

"Sell in May and go away" is an old investment adage.

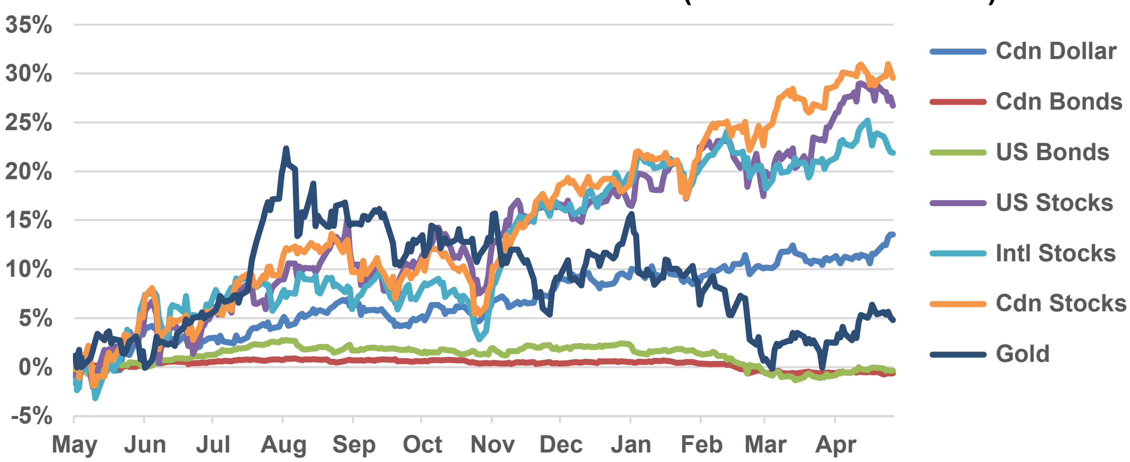
With some higher valuations and increasing areas of speculation, it might be a time to be a little more cautious.

We are entering a slower seasonal stretch for stocks (the old adage is to "sell in May and go away"). Over the last half dozen years, stocks have defied this seasonal trend. However, with a combination of some localized speculative frenzies and generally higher historical average valuations for the major stock market indices, there could be some vulnerability this time around. Despite the market's good year-to-date performance, some smaller growth companies have faced considerable volatility. Will this be contained to those areas, or will the volatility spillover into higher quality names?

If there is any shift in talk from the central bankers to more restrictive policies to keep a lid on inflation, the overall market could hit a rough patch. However, the consensus is that it might not be until late August at the earliest when policymakers begin to test those waters.

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**).[6]

Chart 3:
12-Month Performance of the Asset Classes (in Canadian dollars)



Source: Bloomberg Finance L.P. as of 5/7/2021 for the interval from 5/1/2020 to 4/30/2021

[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 Spending Stimulus	Significant	Positive
2. Coronavirus Geopolitics	Moderate	Negative
3. Canadian Dollar Decline	Moderate	Positive
4. Canadian Federal Economic Policy	Moderate	Negative
6. Short-term U.S. Interest Rates	Moderate	Positive
5. China's Economic Growth	Moderate	Negative
9. Global Trade Wars	Moderate	Negative
8. Deglobalization	Medium	Negative
7. Canada's Economic Growth (Oil)	Light	Positive
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.

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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 May 7, 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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