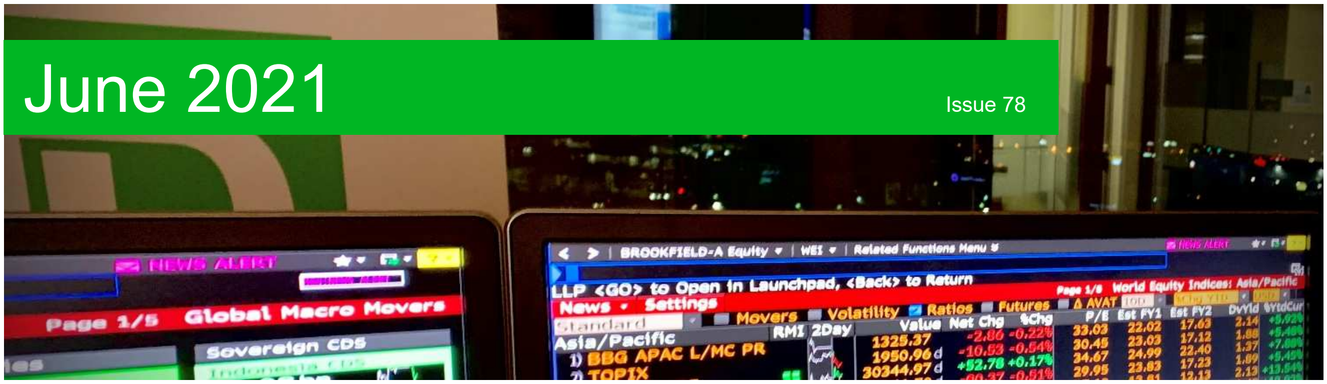
The Charter Group Monthly Letter



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Economic & Market Update

Who Are We Going to Depend Upon?

The workforce does not include everyone. Children are busy in school. Retirees enjoy being unburdened from the daily grind. Health prevents many from working. And, some people just don't want to work.[1]

There are significant economic implications impacted by the number of people outside the workforce versus the number of people in it. The people in it are those that pay the bulk of the taxes to make sure that everyone is reasonably looked after.

Economists and demographers measure this by using the "dependency ratio," which adds up everyone from the ages of zero to 14, and then adds everyone over the age of 64, and then divides this by the total population. Clearly, this is fairly lazy and generalized as it assumes that everyone from the ages of 15 to 64 is working or has the ability to work.

An economy depends upon those in the workforce who pay taxes.

When the workforce declines, there is less potential tax.

However, workers also realize they are a scarcer commodity and might begin to use this as bargaining power.

[1] From an economic perspective, I would view those who support workers but don't earn an actual paycheque to also be included in the workforce. In many cases, a breadwinner would be much less productive without the support of a spouse or other family members.

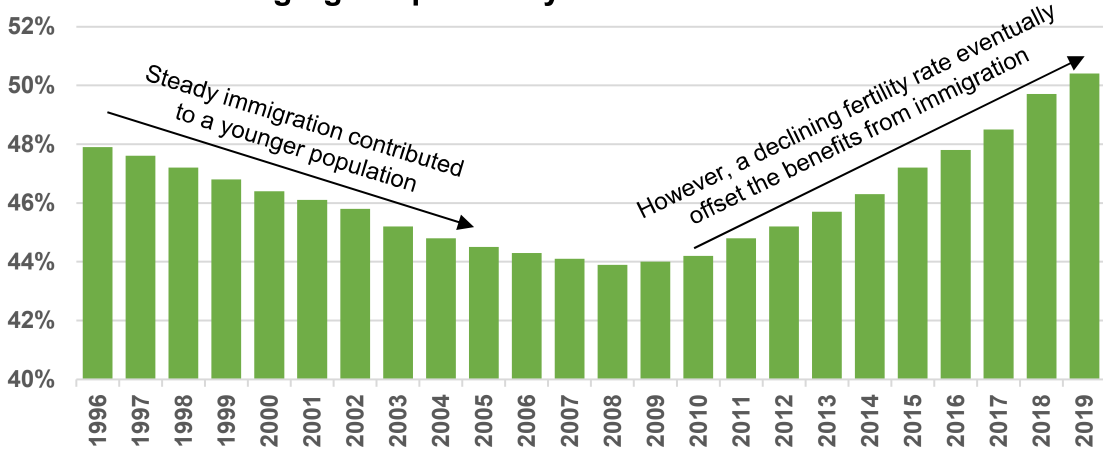
However, over time, changes in the dependency ratio can provide trend insights and warnings if it appears that it is becoming too extreme.

Canada's dependency ratio has been rising for the last dozen years.

Canada saw its dependency ratio rise above 50% in 2019 (**Chart 1**).[2] It might be reasonable to conclude that it has risen even higher since then as immigration into Canada tends to increase the proportion of working-age people and Pandemic-related restrictions have notably reduced immigration over the last 15 months.[3]

Chart 1:

Canada's Working Age Dependency Ratio



Source: Trading Economics & The World Bank, June 4, 2021. Age Dependency Ratio is the ratio of dependents (people younger than 15 and older than 64) relative to those of working age (between 15 and 64). Data are shown as the proportion of dependents per 100 working-age population.

The pandemic might have accelerated the growth in Canada's dependency ratio.

As bad as the general dependency ratios look for Canada (as well as other countries), the situation may be even worse than it appears. Employment data for April pointed to an apparent paradox. Unemployment continues to be elevated compared to where it was pre-pandemic. Yet, employers are reporting record unfilled job openings.

Some of the explanations put forth include people who remain uncomfortable going back to work because of concern over potential infection. Limitations on travel and mobility might have impacted the ability of someone to pursue a job in another part of the country. There may be a growing mismatch between skills and the jobs available. Or, people who have been recipients of pandemic relief money might be de-incentivized from working (in some U.S. jurisdictions, people were getting paid more to stay home than sweating it out

[2] The dependency ratio for 2020 is not available. I was a little late in filling out my census form online last week (I even received a warning notice), so perhaps Statistics Canada was waiting for me!

[3] Shelby Thevenot, "One year later: How the pandemic is affecting Canadian immigration." CIC News, March 18, 2021. 2020 saw 184,000 new permanent residents in Canada, the lowest level since 1998. In 2019, the number was over 300,000.

at work). Regardless of the reasons, it appears that workforce populations have shrunk.

So, the working-age proportion of the overall population has fallen while things have been further exacerbated by a voluntary decline in employment within that working-age population.

This is a serious issue as empirical evidence that suggests that a smaller workforce has more bargaining power.[4] A number of articles in the press recently have highlighted the need to raise salaries or to offer signup bonuses in order to attract workers. If these stories persist, workers might begin to adjust their renumeration expectations accordingly. Since labour can constitute a large component of the cost of goods and services sold, businesses would need to raise prices in order to maintain profit margins. "Wage push inflation" was a scourge of the 1970s which, when combined with monetary inflation factors, created big problems for politicians and policymakers.

Over the past three decades, one of the solutions to such higher wages in North America was to send manufacturing overseas, primarily to East Asia. However, poor demographics, rising dependency ratios, and the risk of wage push pressures are also evident in that part of the world (**Chart 2**).

The dependency ratio in Asia is also rising which has implications for the cost of goods that we import from the region.

As mentioned above, slowing immigration can increase the dependency ratio. Previously, this was not an issue for many of the countries in East Asia because of the historically high fertility rate. However, those days are over. Last year, South Korea saw more deaths than births[5], and the People's Republic of China (PRC) is on the verge of experiencing a population decline.[6] (if it is not already in the midst of one[7]). In a somewhat hasty response, the PRC is now permitting couples to have up to three children[8] (but, remember, in order to produce the needed 20 year-olds, biology tells us it takes 20 years plus nine months).

However, liberal immigration policies in East Asia, outside city states of Singapore and

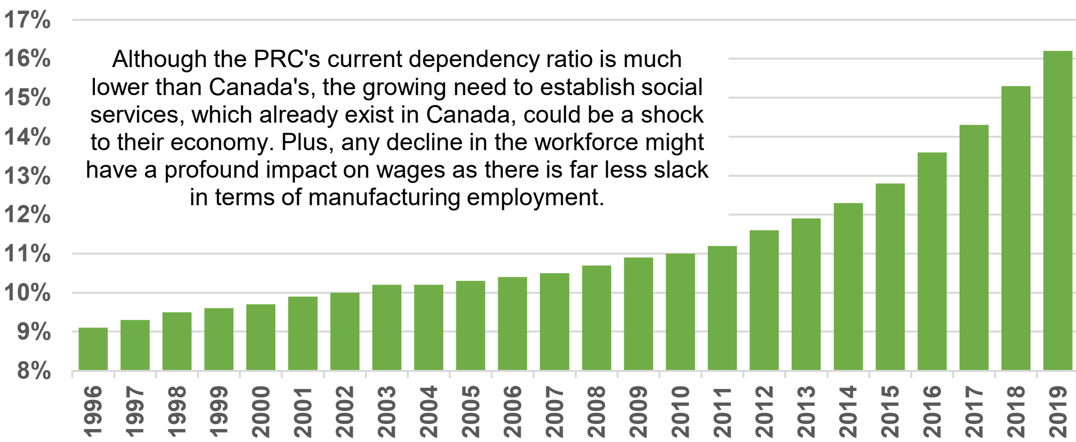
[4] Charles Goodhard & Manoj Pradhan, *The Great Demographic Reversal: Ageing Societies, Waning Inequality, and an Inflation Revival*. Palgrave Macmillian, 2020.
[5] Sam Kim, "Population Rubicon Crossed in South Korea Is a Warning to the World." Bloomberg News, May 25, 2021.
[6] "China's census shows its population is nearing its peak." *The Economist*, May 15, 2021.
[7] There were some indications that China's population had already shrunk in the initial release of census data earlier this month. However, officials rejigged some of the data to conclude that the population would not crest for another four years, in 2025. Four more years of growth likely won't make much of a difference anyway.
[8] "China's Three-Child Policy May Do Little to Boost Birthrate." Bloomberg News, May 31, 2021.

Hong Kong, have been a total political non-starter and there is not much prospect that anything will change anytime soon.

Although there are domestic implications of rising dependency ratios in Asia, it is the impact of rising wage costs for products that are exported that concern portfolio managers like me. It could be a long-term source of imported inflation for North America, impacting consumers' buying power and the profit margins of listed companies in which we invest.

Chart 2:

Peoples Republic of China's Working Age Dependency Ratio



Source: Trading Economics & The World Bank, June 4, 2021. Age Dependency Ratio is the ratio of dependents (people younger than 15 and older than 64) relative to those of working age (between 15 and 64). Data are shown as the proportion of dependents per 100 working-age population.

The inflationary aspect of declining workforces also severely tests some recently popular economic theories such as Modern Monetary Theory (MMT) and Universal Basic Income (UBI). MMT basically espouses that those governments which are permitted to print money face no upper limit to the amount of debt they can issue. If the debt becomes too burdensome, the government can just print money to pay it off. MMT proponents argue that inflation is mainly driven by excess demand rather than by an expanding money supply. And, if there are no consequences to issue debt and printing money, then why not offer everyone a minimum income (UBI) in order to reduce inequalities and hardships?

Recent popular theories advocating unlimited government borrowing to pay everyone a living wage have largely omitted the potential of shrinking work forces and the inflationary risk this presents.

People can theorize all the want regarding the ability to control inflation in the face of infinite monetary expansion, however, the real-world case study conveniently provided by the pandemic, with the wage push factors resulting from a decline in the workforce, provide growing actual evidence that there are hazards to de-incentivizing people from working, the very people the economy depends upon.

The real-world impact of the pandemic has challenged the assumptions embedded in these theories.

Model Portfolio Update[9]

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 May.

No changes to the portfolios in May.

Gold bullion and Canadian stocks were the engines for the model portfolios during the month. Gold may have risen as investors questioned the merits of cryptocurrencies as reliable inflation hedges and shifted their focus to gold instead. A number of press reports indicated that financial institutions that were previously dabbling in cryptocurrencies also did the same.

Gold was higher as investors looked for more reliable inflation-hedging.

Canadian stocks were the benefactor of investors looking to capitalize on the post-pandemic reopening of the economy. Canada is seen internationally as a leader in the export of raw materials, inputs for finished goods that are expected to be in high demand as consumers look to 'reward' themselves after playing it safe for the past 16 months.

Canadian stocks were higher as the global economic reopening is expected to increase demand for raw materials, a Canadian specialty.

[9] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 6/4/2021. 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 also saw some lift as international investors needed some Canadian currency to purchase Canadian stocks. However, the dollar stumbled a little towards the end of the month as some strategists started to question the resilience of the commodity price gains. After all, the reopening of the economy is mostly a finite event and investors may want some reassurance that there will be other reasons to drive the global demand for resources beyond the next year or so. The Australian dollar, in many ways our sister commodity currency, has lost over 6% of its value since almost reaching parity with the Canadian dollar in late February.[10] That could be a harbinger of what is to come for the Canadian dollar.

The Canadian dollar performed well in the early part of May but has levelled off since then.

The Australian dollar, similar as a commodity exporter currency, has declined versus the Canadian dollar since February which may provide a cautionary note for the loonie.

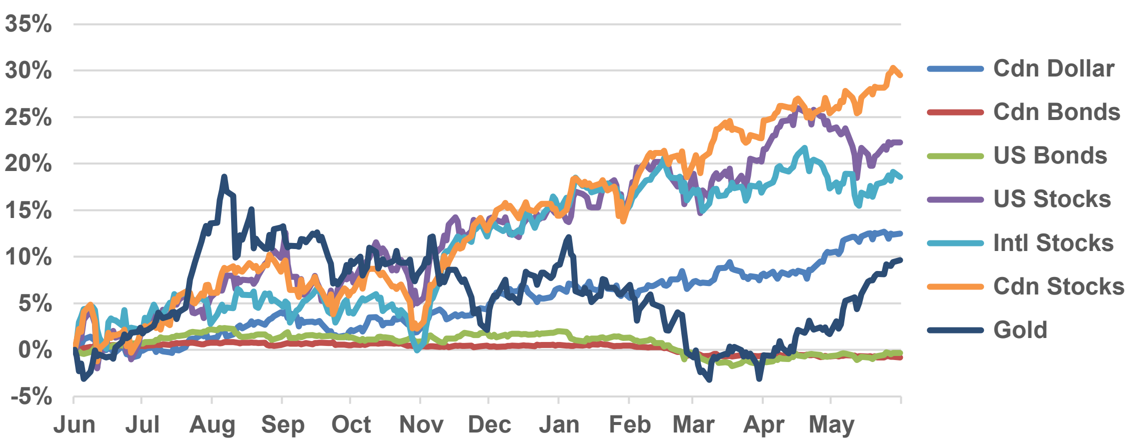
Overall, stocks look to benefit from continued government spending and central bank monetary stimulus. As mentioned in the previous issue of the *Monthly Letter*, the Annual Economic Symposium in Jackson Hole, Wyoming in late August is the next junction observers are looking to for any hint of a change in direction as it relates to the current pace of economic stimulus (barring unforeseen economic developments in the interim).[11]

Economists continue to look ahead to late August for hints on continued pandemic-related stimulus.

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**).[12]

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 6/1/2020 to 5/31/2021

[10] Source: Bloomberg Finance L.P. as of 6/4/2021

[11] An event hosted by the Federal Reserve Bank of Kansas City (one of the 12 regional Reserve Banks in the U.S.). Traditionally, this has been the premier global central banking conference and brings together the leading monetary policymakers from around the world.

[12] 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[13]

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

[13] 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 June 4, 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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