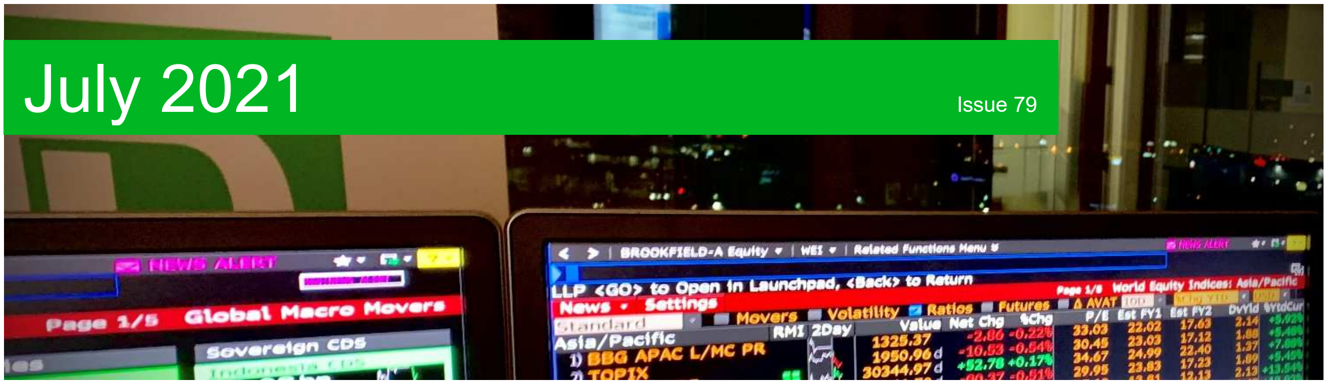
The Charter Group Monthly Letter



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Economic & Market Update

And Now, Back to Regularly Scheduled Programming

Much of what I have read in the financial news suggests that the pandemic represents a new starting point for the economy. It's as though the pre-pandemic economy has been relegated to an insignificant curiosity that has no bearing on the fundamentals driving growth going forward.

A fresh start. A clean slate. A do-over. Perhaps economists and financial commentators believe that all we need is a global pandemic to transform a lagging economy into one that will propel us through the 2020's.

It is hard to argue that the emergency fiscal and monetary measures have not provided monumental vigour to the economy. Despite some documented demographic inequalities and some unevenness among various countries, the global economy has grown like gangbusters when measured back to the low ebb when the pandemic unfolded last spring.

Once all the pandemic-related stimulus ends, will we have a brand-new economy? Or, will it still be the old one from before the pandemic?

However, recent government largesse has obscured many of the underlying economic forces that had been well established before the pandemic. Much of what we have seen recently merely impacts the economy at the margin. Afterall, growth (and contraction) are "marginal" concepts. Such measures do not capture the size and scale of the economy, and the inherent inertia which can eventually temper all the stimulus policies.

Pandemic-related monetary growth and government spending might be leading some to believe that the economy is transforming.

The economic forces in the 18 months before the pandemic were not generally positive. Despite worsening economic indicators, the U.S. Federal Reserve (the Fed) was focused on normalizing monetary policy after years of emergency measures to deal with the Sub-prime mortgage crisis and the resulting Great Recession over a decade ago. The stock markets initially protested by selling off (**Chart 1**). The selling ceased when Jerome Powell, the Chair of the Fed, signaled that the Fed would pause its normalization. This was enough to prompt the bond market to drive up bond prices and, correspondingly, lower the longer-term yields (**Chart 2**). Such action is consistent with worries regarding a weakening economy.

Instead of transformation, pandemic relief measures may only be temporarily obscuring pre-pandemic weakness.

Chart 1:
Dow Jones Industrial Average (Large U.S. Stocks)

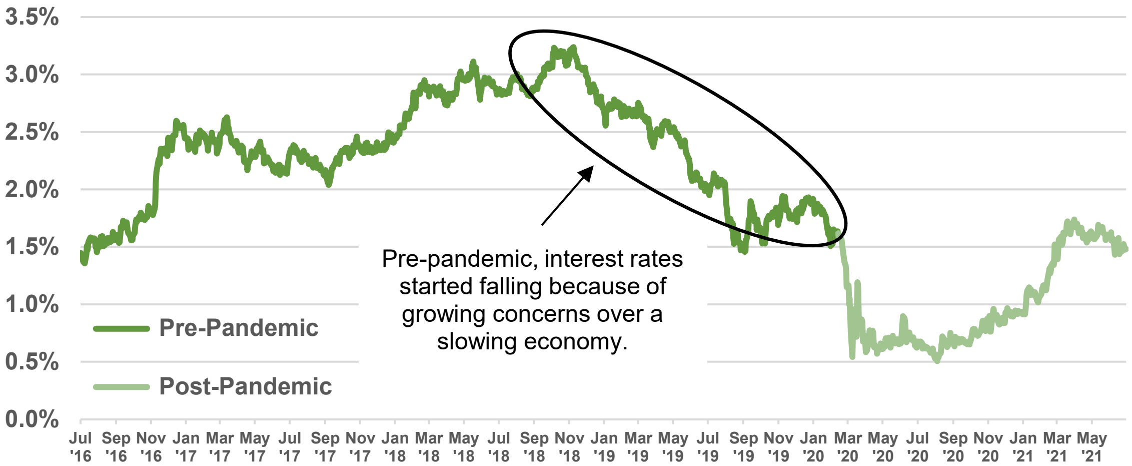
Source: Bloomberg Finance L.P. as of 7/2/2021

Then the Fed went a step further when it suggested that it was ready to reverse the normalization by *cutting* the Fed Funds Rate. On July 31, 2019, it followed through by lowering the Rate by ¼% (**Chart 3**). This was followed by two more ¼% rate cuts on September 18 and October 30, not exactly a ringing endorsement for the economy.

The pre-pandemic economy had already weakened enough to prompt central bank intervention.

Chart 2:

Yield on 10-year U.S. Treasury Bond



Source: Bloomberg Finance L.P. as of 7/2/2021

There weren't many indications that the economy was ready to rebound from the time of the last Fed Funds Rate cut to about four months later when the pandemic began to have its first detectable impact on the investment markets.[1]

Recent economic strength is because of an expanding money supply and massive government spending which can't be sustained indefinitely.

With the onset of the pandemic, the massive fiscal and monetary responses quickly overwhelmed the existing economic trends. Given the magnitude of the additional liquidity and spending, which had no historical peer, it is understandable that markets began to react positively to the emergency policies.

Most of those emergency policies are still in place today. As a result, we may have investors reacting to the ongoing stimulus rather than paying any attentional to the underlying pre-pandemic economic fundamentals that haven't gone away.

What happens when the ongoing stimulus is reigned in?

Commentators appear to be assuming that the stimulus itself will establish a new trajectory with sufficient strength to counteract the inertial of the pre-pandemic trends. I assume that policymakers would be pleased with such an outcome. But, is this wishful thinking?

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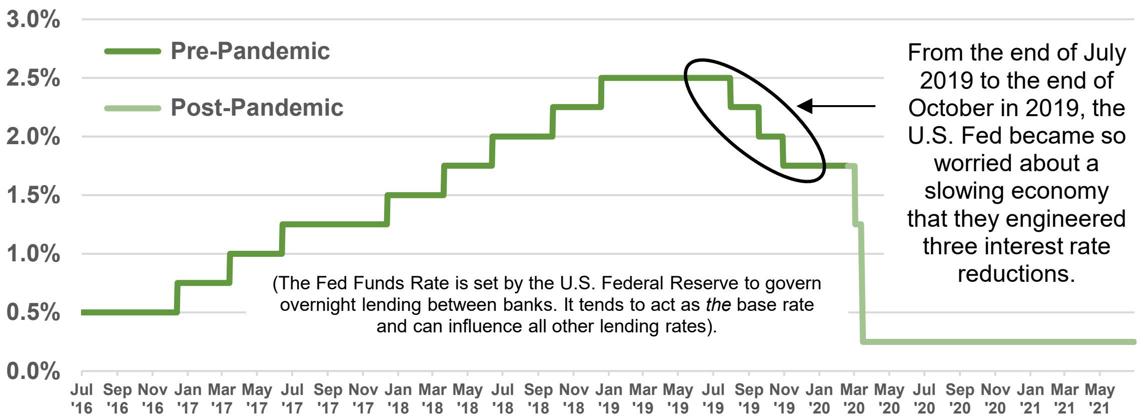
[1] By my estimation, the impact of the pandemic did not hit the markets until February 19, 2020. On that day, the Dow Jones Industrial Average began to selloff from its previous record high. Then, the next day, February 20, 2020, the yield on the U.S. 10-year Treasury bond fell below previous support levels. From this point, there was a clear break with previous trends.

Chart 3:

Federal Funds Rate (Upper Bound)



Source: Bloomberg Finance L.P. as of 7/2/2021

If all it takes to dramatically turnaround an economy is massive stimulus, why wait for a pandemic? Why not just make that the permanent policy?

If it was safe to indefinitely rely on stimulus, then why wait for a pandemic?

Common sense might suggest that such a permanent policy would be financially unstable. Free money, to put it bluntly, isn't real money. Money has value because relative scarcity. It keeps prices for goods and services in an equilibrium. It provides us with the incentive to work and be productive.

Once the flood of stimulus ebbs away, we may re-inherit the pre-pandemic anemic growth except where the prices for goods and services are appreciably higher than they were before. The money that was created and distributed could seep into prices (economists have described this in the past as "more money chasing too few goods relative to demand"). Plus, there are also the well-documented employment enticements and higher wages which could be tacked on to prices if producers and retailers want to maintain their profit margins.

It is important to note that there are virtually no policymakers within government or at central banks that are forecasting such a scenario. Instead, their consensus conclusion appears to be temporary inflation accompanying a reinvigourated economy poised to grow for the foreseeable future. A nice bonus as a result of the pandemic, so to speak.

Once the stimulus fades, we might just end up with the old pre-pandemic economy but with higher prices and higher wages.

Sounds great. But, try and find a policymaker who forecasted the subprime mortgage crisis and the Great Recession that ensued between 2007 and 2009. Wishful thinking is likely not a great way to anticipate reality.

Model Portfolio Update[2]

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 during June. However, we added shares in Fluor Corp to our U.S. Equities allocation while reducing shares in the iShares S&P 500 Value ETF.

No changes to the asset allocations in the model portfolios during June.

Fluor Corp is a Texas-based engineering and construction firm with a significant number of energy industry-related projects (both traditional and green). Fundamentals look very attractive relative to price. Plus, the firm is shifting away from fixed-price contracts where it assuming the responsibility for cost overruns (SNC Lavalin is also undergoing a similar strategy shift). In fact, its last large fixed-price project is the LNG Canada site up in Kitimat. There are still some pricing risks with that contract which may have dampened the near-term enthusiasm for the shares. But, once that hurdle can be navigated, there is a pipeline of less risky "cost-plus" projects. Plus, Fluor is the only maker of small-scale nuclear reactor that has received approval from the U.S Nuclear Regulatory Commission, which

However, Fluor Corp., a U.S. engineering and construction firm, was added to the U.S. asset class.

[2] 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.

fits with our longer-term view of the need for scalable and reliable sources of energy to fuel the burgeoning electric vehicle market.

The U.S. dollar strength was a negative for the portfolio as it reduced the value of the gold bullion position.

During the month, the advance in the U.S. dollar versus the Canadian dollar accentuated the returns from the U.S.-listed investments. However, this also had a detrimental effect on the value of the our relatively significant position in gold bullion.

Stocks, which continued their rise from the pandemic lows of last year, were a positive contributor to the portfolio results in June.

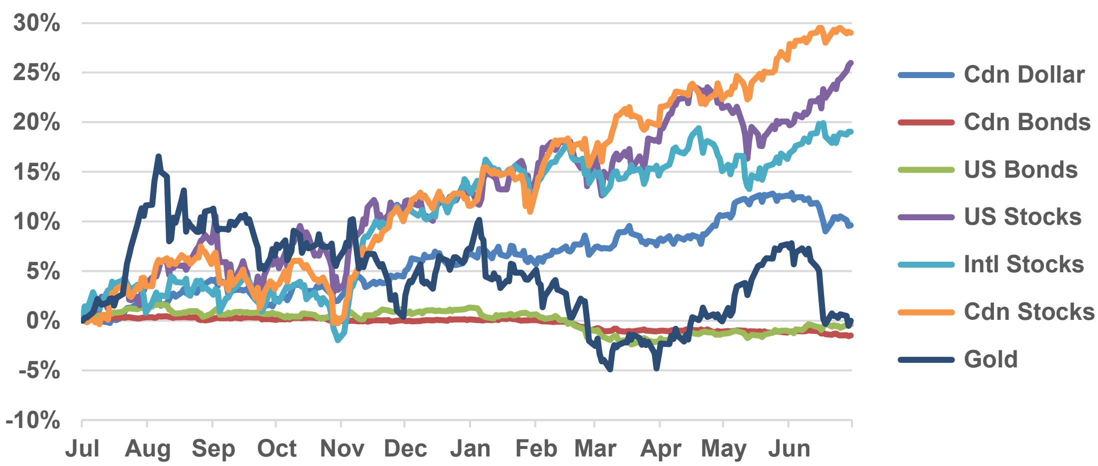
The general strength of stocks in the U.S., Canada, and internationally was the major positive contributor to portfolio results in June. Continuing government stimulus was likely the source of lift for equities.

Looking forward, government stimulus is unlikely going to diminish over the near-term. Although there are growing debates about scaling back government help, the arguments over timing focus more on 2022 or 2023 as opposed to the near-term. As mentioned in previous editions of *The Charter Group Monthly Letter*, we may have to wait until the annual central banker conference in Jackson Hole, Wyoming at the end of August for a clearer signal on the timing.

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 4**).[3]

Chart 4:

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



Source: Bloomberg Finance L.P. for the interval from 7/1/2020 to 6/30/2021

[3] 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[4]

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

[4] 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 July 2, 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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