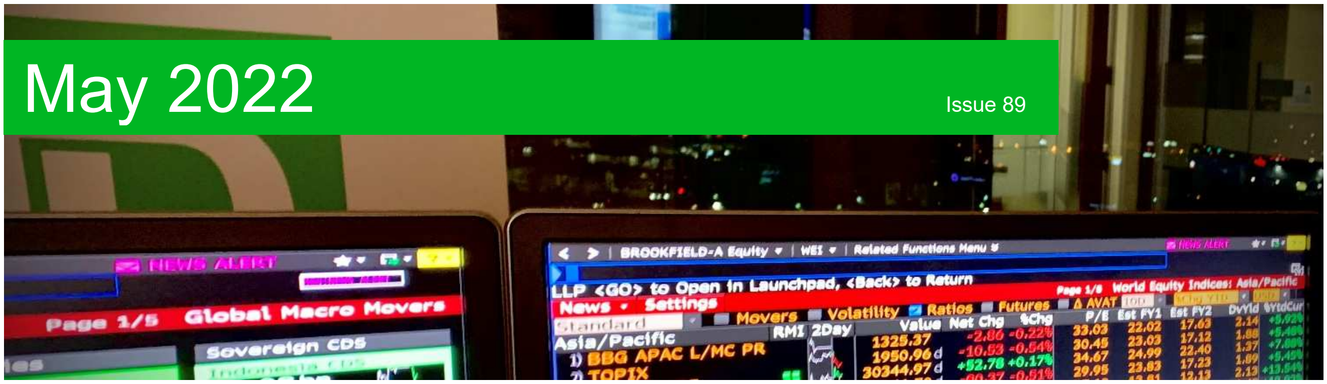
The Charter Group Monthly Letter



May 2022

Issue 89

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

Economic & Market Update

Inertia-flation

The good news: There is a very good chance that inflation will crest soon.

The bad news: It won't be exactly what it appears to be.

In the next couple of months, the year-over-year inflation numbers for Canada and the U.S. will be compared to the already relatively high level of inflation 12 months ago. Growth from a low base can be eye-popping. Growth from high base is often much less impressive.

It is also worth noting that when inflation is presented in the news, it is almost always expressed as the change in the "rate of growth" of inflation.[1] When that rate of growth falls, it looks like inflation is falling. That's not what's happening. It just means that it is growing at a slower annual rate. However, it is *still* growing!

The inflation numbers reported in the media often don't convey the extent of the economic pain for consumers or how long it might last.

Often the numbers can produce "false dawns" where it looks like inflation is retreating but is still lurking.

[1] Specifically, this is the annual change in the Consumer Price Index observed at the end of each month. The U.S. number is published about 10 days after the month by the U.S. Bureau of Labor Statistics. The Canadian number is published by Statistics Canada about 18 days after the month.

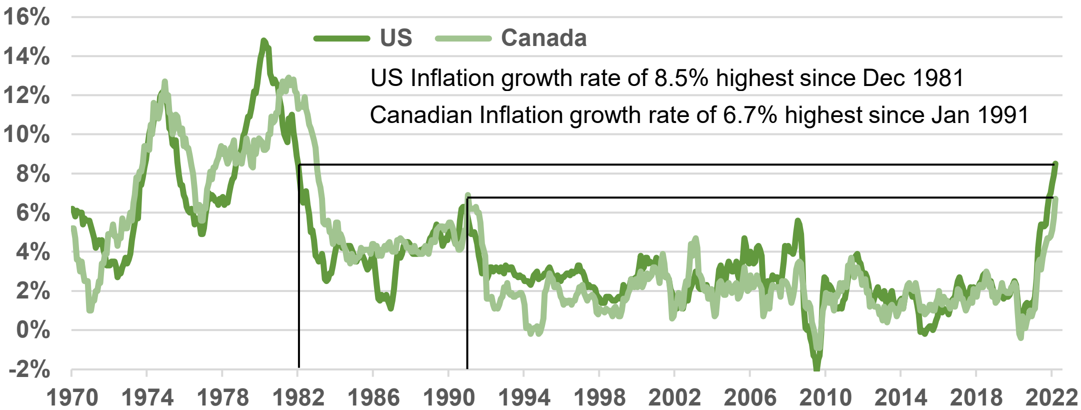
TD Wealth

The annual rate for inflation growth at the end of March was 8.5% for the U.S. and 6.7% for Canada (**Chart 1**). At those rates, the price of most things would double in the U.S. over the next 8 ½ years and would double in Canada over the next 10 ½ years. However, the historical evidence indicates that inflation growth rates rarely maintain such high levels. Much of that is because of the "high base effect" discussed above.

Current inflation growth rates are the highest in decades.

Chart 1:

Annual Inflation Growth Rate (The Consumer Price Index)



Source: Bloomberg Finance L.P. as of 5/2/2020

The current *forecasted* U.S. inflation annual growth rate for end of April 2022 is 6.9%.[2] In addition to the base effect, some economists have also factored in an element of "demand destruction" (higher prices reduce affordability for some consumers) and are anticipating some easing of economic pressure as a result of recent lockdowns in the People's Republic of China.

The annual rate of inflation growth may ease due to the comparatively high base from last year.

But that doesn't mean that prices are coming down.

However, politicians and policymakers may claim some victory and pause on the interest rate hikes.

Let's say these banks and economists are right and the next inflation growth rate number is 6.9%. Politicians and policymakers could infer that inflation is "transitory" like they were trumpeting up until last November. The media might communicate that we are past the worst of it. There could be some incentive for central bankers to ease off on the hawkish rhetoric that might be scaring some investors and consumers. That could be very tempting for policymakers who have leaned towards being monetarily dovish in most instances over the last two decades. It would be reasonable to conclude that they don't want to induce a recession via higher interest rates designed to quell inflation, or that they wouldn't want to induce one simply by scaring the population into believing that one is inevitable. Plus, there are the U.S. midterm elections this November. Democrats could be in some

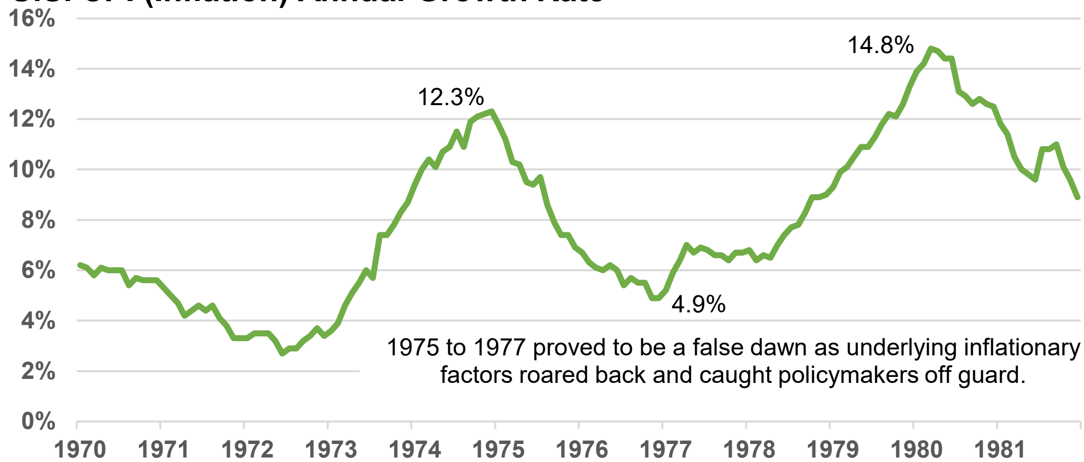
[2] Source: Bloomberg Finance L.P. as of 5/2/2022. This forecast consensus is derived from surveys conducted by Bloomberg and from forecasts submitted by various banks.

difficulty if they need to explain to their constituents why higher interest rates are needed if inflation appears to be easing off. Democrat leaders may try to nudge policymakers.

As mentioned above, even though the annual inflation growth rates could ease, the general level of prices would still rise, albeit at a slower rate. Using the example of the 1970s inflation era, **Chart 2&3** show the difference between the growth rate and the level.

Chart 2:

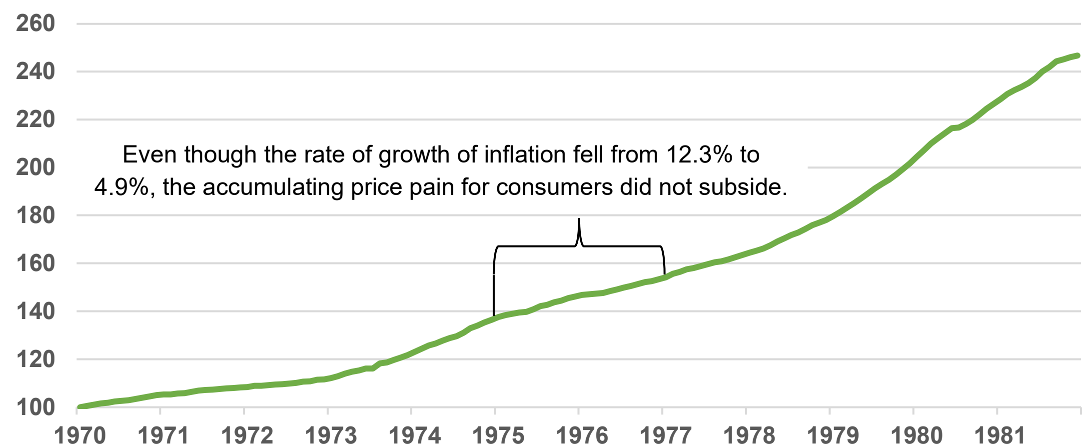
U.S. CPI (Inflation) Annual Growth Rate



Source: Bloomberg Finance L.P. as of 5/2/2022

Chart 3:

U.S. CPI Level (Indexed to 100 on January 31, 1970)



Source: Bloomberg Finance L.P. as of 5/2/2022

Consumers usually figure out that slowing inflation growth still means rising prices.

Chart 3 clearly shows that there was no relief for consumers in the form of lower prices despite a precipitous drop in the inflation growth rate in the middle part of the decade. If people were holding off purchasing, hoping that there would be a drop in prices as the falling growth rate appeared to suggest, they would have eventually been hit by the harsh reality that they were making a mistake. It might have looked like policymakers were winning the war on inflation in 1975 but, from a consumer perspective, inflation, and the pain it caused, raged on. There were a few economics textbooks that I remember from the 1980s arguing that workers in the mid-1970s demanded increasingly higher wages because their pain persisted despite the inflation growth rate coming down. This induced a wage-price spiral which, in addition to a few other factors, fueled a second spike in the inflation growth rate at the end of the decade.

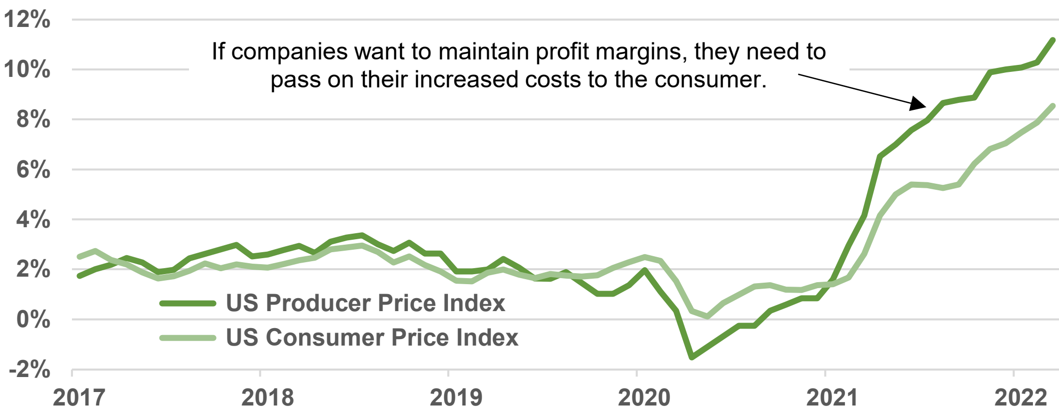
If consumers do figure out that prices are continuing to rise, they may demand higher wages which, in turn, can contribute to yet more inflation.

With the current situation, we might get a similar effect, where the inflation growth rate looks better as we head into the summer, but consumers still feel the pain. Also, there are a few compelling reasons as to why the growth rate might accelerate again. The prices that producers (manufacturers) are required to pay for their raw materials and inputs have accelerated faster than consumer prices recently (**Chart 4).** That is an indication that these rising input costs have not yet been fully passed on to the consumer. As long as the U.S. Producer Price Index is growing at such a rate, the harder it will be for the growth rate of consumer inflation (the main gauge, or Consumer Price Index) to decrease much.

Producer prices are rising faster than consumer prices. Eventually producer prices need to be passed on in the form of higher consumer prices in order to maintain profit margins.

Chart 4:

Producer Price Inflation Growth vs Consumer Price Inflation Growth



Source: Bloomberg Finance L.P. as of 5/2/2022

Up until last November, the U.S. Federal Reserve and the Bank of Canada were emphatic in their belief that inflation was "transitory." Their respective easy-money policies rested heavily upon that notion. However, in these pages, I frequently wrote about how the factors adding to the current inflation could stay around for a while.

Unless there is a big change of events economically and geopolitically in the near future, our policymakers, and we as consumers, may be re-introduced to the power of inflationary inertia last seen in the 1970s.

Central banks were hoping that inflation would just be transitory.

However, the complex nature of inflation can make it self-perpetuating for an extended period.

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 or the individual securities in the model portfolios during April. The proceeds a March bond maturity remained in cash, which was likely a good thing as the bond market suffered along with the stock market over the month. If the Bank of Canada eases off the hawkish interest rate rhetoric for fear of inducing an economic slowdown, we might get more stability in the bond market, allowing for a more opportune entry point.

No changes to the asset allocations or security holdings during April.

Proceeds from a bond maturity in March remain in cash.

The only April gain among the asset classes that we use for the model portfolios was gold which climbed a meager 0.48% in Canadian dollar terms.[4]

Gold was the only positive asset class during the month.

Almost all stock markets everywhere were down. Fortunately, the sectors and companies that were hit the most are where have little exposure. U.S. growth stocks suffered as investors questioned their business models and propositions to shareholders in a higher

Prominent technology companies were subject to heavy selling.

[3] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 5/2/2022. 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.
[4] Source: Bloomberg Finance L.P. as of 5/2/2022.

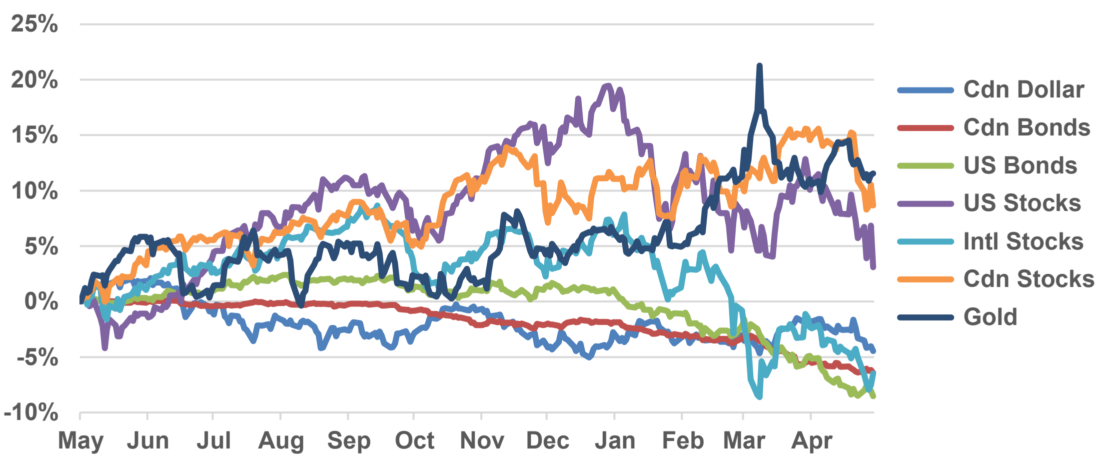
inflation/higher interest rate environment. Although U.S. value stocks were a relative safe harbour, they also fell in absolute terms. Canadian stocks, which held their ground well in the first three months of the year as commodity prices spiked, finally got hit along with everything else and are now down 2.17% year to date.[5]

Value stocks, inflation hedges, and companies with pricing power were generally not impacted as much.

The inflation hedges, and the focus on pricing power, dividends, and strong balance sheets, helped the model portfolios to avoid the fate of the general stock market and bond market indices. The decline in the Canadian dollar vs the U.S. dollar also helped. Year to date, the Dow Jones Industrial Average is down 9.25%, the S&P 500 Index is down 13.31%, the NASDAQ Index (heavily weighted with technology stocks) is down 21.16%, the Bloomberg US Aggregate Bond Index is down 9.50%, and the Bloomberg FTSE TMX Core Canadian Universe Bond Index is down 11.23%. Check your statements, or give us a call; the model portfolios tell a different story.[6]

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 5**).[7]

Chart 5:
12-Month Performance of the Asset Classes (in Canadian dollars)



Source: Bloomberg Finance L.P. for the interval from 5/1/2021 to 4/30/2022

[5] Source: Bloomberg Finance L.P. as of 5/2/2022. Using the TSX/S&P Composite Index as a proxy for Canadian stocks.
[6] Source: Bloomberg Finance L.P. as of 5/2/2022
[7] 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[8]

Issue	Importance	Potential Impact
1. Global Geopolitics	Significant	Negative
2. Canadian Dollar Decline	Moderate	Positive
3. Canadian Federal Economic Policy	Moderate	Negative
4. China's Economic Growth	Medium	Negative
5. Inflation (Portfolio Impact)	Medium	Positive
6. U.S. Fiscal Spending Stimulus	Medium	Positive
7. Short-term U.S. Interest Rates	Medium	Negative
8. Global Trade Wars	Medium	Negative
9. Long-term U.S. Interest Rates	Medium	Negative
10. Canada's Economic Growth (Oil)	Light	Positive

[8] 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 | Senior Portfolio Manager & Investment Advisor
Mike Elliott, BA, CIM®, FCSI® | Senior Portfolio Manager & Investment Advisor
Kiran Sidhu, BCom, CIM®, CFA | Associate Investment Advisor
Laura O'Connell, CFP®, FMA | Associate Investment Advisor
Kelsey Sjoberg | Administrative 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.

The information contained herein is current as of May 2, 2022.

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.

Certain statements in this document may contain forward-looking statements ("FLS") that are predictive in nature and may include words such as "expects", "anticipates", "intends", "believes", "estimates" and similar forward-looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest and foreign exchange rates, equity and capital markets, the general business environment, assuming no changes to tax or other laws or government regulation or catastrophic events. Expectations and projections about future events are inherently subject to risks and uncertainties, which may be unforeseeable. Such expectations and projections may be incorrect in the future. FLS are not guarantees of future performance. Actual events could differ materially from those expressed or implied in any FLS. A number of important factors including those factors set out above can contribute to these digressions. You should avoid placing any reliance on FLS.

Index returns are shown for comparative purposes only. Indices are unmanaged and their returns do not include any sales charges or fees as such costs would lower performance. It is not possible to invest directly in an index.

The Charter Group is a part of TD Wealth Private Investment Advice, a division of TD Waterhouse Canada Inc. which is a subsidiary of The Toronto-Dominion Bank.