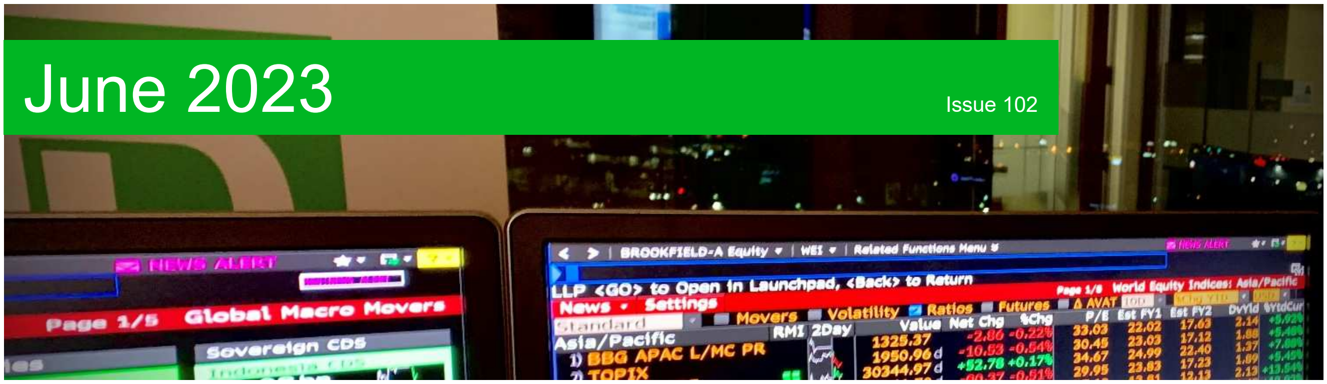
The Charter Group Monthly Letter



June 2023

Issue 102

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

Economic & Market Update

The Magnificent Seven

Sometimes when analyzing the major investment indices, one can arrive at a conclusion that might be quite different from the underlying reality.

Sometimes the appearance of strength in a stock market index can mask an underlying weakness.

Looking at the year-to-date results of the NASDAQ Composite Index and the S&P 500 Index, we might assume that the equities markets are in the midst of a bullish stampede (**Chart 1**). However, when we factor out seven large companies (**Chart 2**), the remainder of the market appears to be in a relatively somber state (**Charts 3 & 4**). Those seven companies currently have a market value of $10.6 trillion USD, so they have the potential to overwhelm the market value-weighted indices that include them.

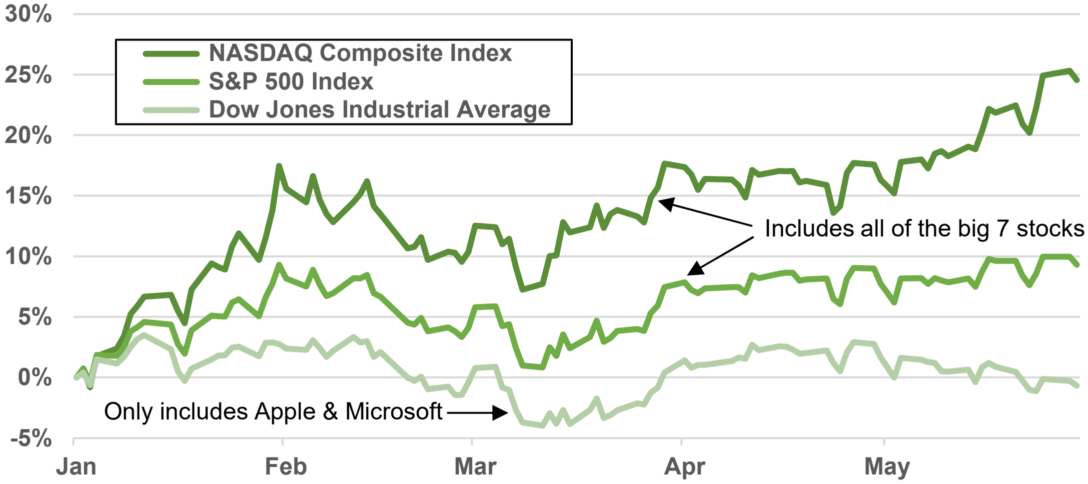
It can be unhealthy if a few large stocks are responsible for a market advance.

"Narrowness" is the term used to describe this phenomenon, and this is the most "narrow" that the U.S. markets have been in my three-decade career. The previous extreme was in late 1999/early 2000 at the height of the Dot.com euphoria and just before the NASDAQ Composite Index (the NASDAQ) went on a 78% skid from its peak in March 2000 to October 2002 (**Chart 5**).

It is assumed that "broad" markets are better than "narrow" markets.

Chart 1:

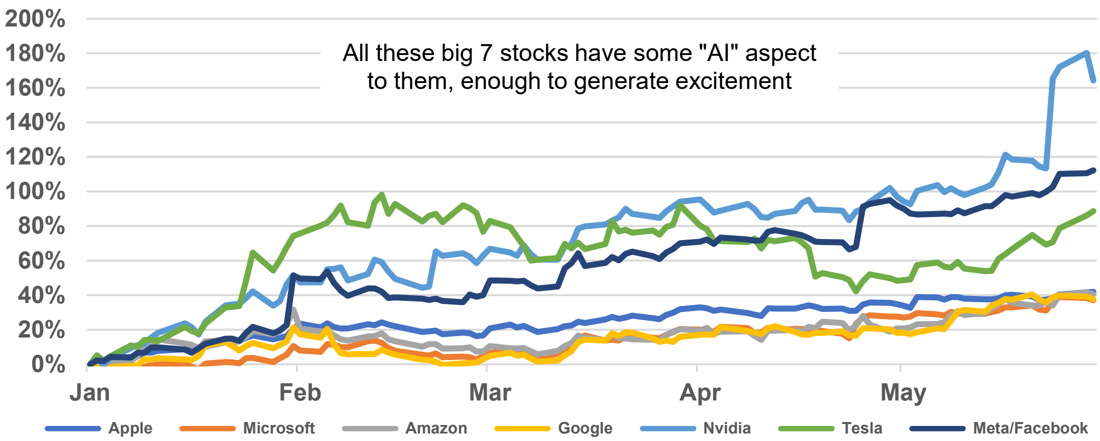
Year-to-Date Performance to May 31, 2023



Source: Bloomberg Finance L.P. as of June 1, 2023

Chart 2:

Year-to-Date Performance to May 31, 2023



Source: Bloomberg Finance L.P. as of June 1, 2023

The NASDAQ may be "narrow" but at least valuations are not as high as they were in 2000.

This lessens the vulnerability a little, but does not eliminate it.

It should be highlighted that the current average valuation of stocks in the NASDAQ are nowhere near where they were in 2000. The average Price-Earnings ratio for the NASDAQ is presently 74 compared to the peak of 175 in March 2000.[1]

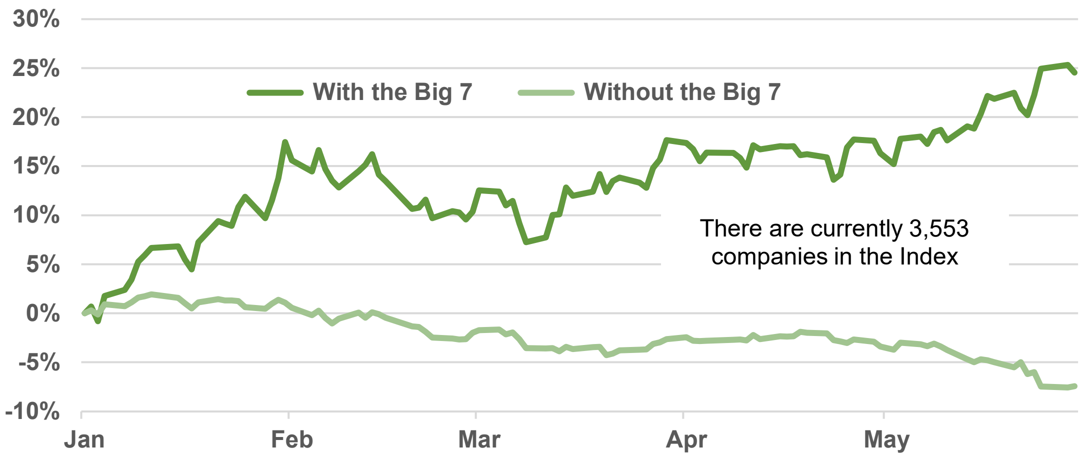
As a result, the overall vulnerability of the NASDAQ may not be what it was in 2000. Instead, the concerns are more focused on the "narrowness" and what would happen if those large stocks gave back a significant portion of what they have gained since the beginning of this year. The rest of the Index could have some difficultly if interest rates

[1] Source: Bloomberg Finance L.P. as of June 1, 2023.

remain elevated and/or if we see some economic slowdown, but that is likely not enough to repeat the Year 2000 "freefall" that impacted most of the stocks in the NASDAQ.

Chart 3:

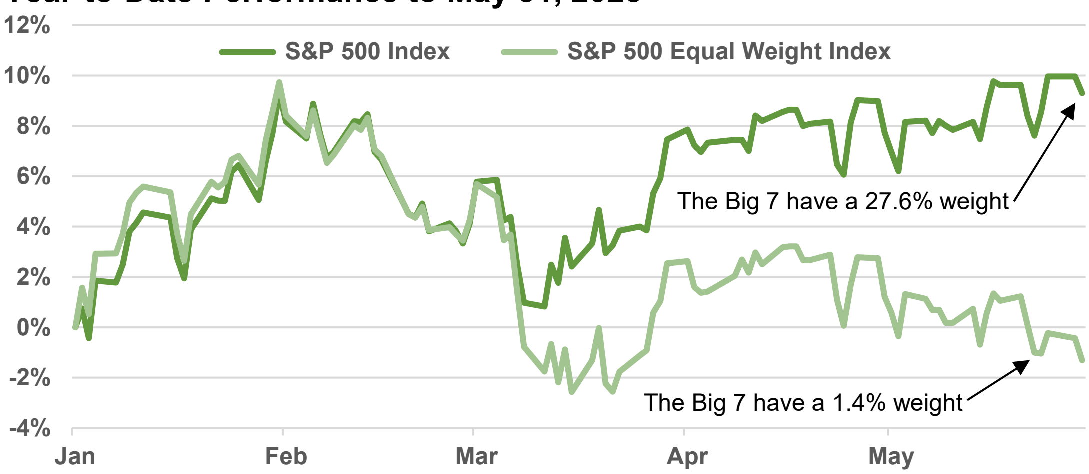
NASDAQ Composite Index - YTD Performance to May 31, 2023



Source: Bloomberg Finance L.P. as of June 1, 2023

Chart 4:

Year-to-Date Performance to May 31, 2023



Source: Bloomberg Finance L.P. as of June 1, 2023

Closer examination of the big seven stocks driving the market reveals two primary factors that are fueling the excitement. The artificial intelligence (AI) frenzy, and the prospect for interest rate cuts in the back-half of this year. Stubborn inflation and persistent economic growth have dissolved most of the rate cut expectations, so those seven stocks have probably become even more dependent on the sustainability of the AI craze.

The artificial intelligence (AI) frenzy is driving those few large stocks lifting up the NASDAQ and the S&P 500.

The focus on AI emerged last October with ChatGPT hitting the news (a chatbot developed by Open AI, which itself is funded in large part by Microsoft, which we own).

What gave the news stories impact was the novelty of finding instant potential solutions to things like writing term papers or helping somebody to pass law school entrance exams, etc. Whether or not people actually succeeded in these endevours using ChatGPT seemed to be beside the point. These stories captured imaginations and provided a foundation for much more fantastical musings, such as AI eventually destroying the world!

The AI story has seductive appeal which gives it staying power, for now.

Chart 5:

NASDAQ Composite Index - 2000 to 2002

Source: Bloomberg Finance L.P. as of June 1, 2023

AI chatbots, as well as other AI applications, have been around for a number of years. However, in the area of "search," Google, which had its own chatbot, was not eager to introduce it as it had the potential to cannibalize its existing business. Google generates over $300 billion a year from online ads that appear on the same page as the multiple search results. In contrast, chatbots produce a single and apparently satisfactory result. There is not much opportunity to slide in an ad to pull the user away from that result.

Microsoft has been one of the driving forces behind the public fascination of the AI story.

Microsoft's search business is a minnow compared to Google's. So, they didn't have much to lose by promoting a chatbot for search. However, Microsoft does offer a "cloud" platform that is designed to support AI and chatbots (or large language models) in particular.

My opinion is that it is way too early to gauge which stocks will generate significant value from AI. Thus, there could be some significant turbulence in the big seven stocks if it appears that some may not be able to monetize the opportunity.

It's too early to tell which companies will win big on the AI battlefield. Even AI is not able to provide the answer!

I asked ChatGPT to help, but its response was: "As an AI assistant, I am here to assist you, but predicting the future for AI companies is not within my capabilities." Now, *that* doesn't seem to measure up to the hype 😊.

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

The asset allocations and the specific securities holdings in the model portfolios remained unchanged in May.

No changes to the model portfolios in May

The asset classes used in the model portfolios were flat to down during the month with TSX/S&P Composite Index (Canadian stocks) leading those declines by -5.06%.[3] Paradoxically, it was the prospect of sustained economic growth that was causing much of the consternation among investors. Prior to May, there was an expectation that inflation was fading and that central banks would have some scope to cut interest rates (which generally helps stocks). Unfortunately, economic growth tends to add to aggregate demand which can be inflationary. A number of the U.S. Federal Reserve officials voiced concerns about price pressures and that it was not time to pull back from the inflation fight by cutting rates. Eventually, that message seeped through to enough investors, resulting in an increasing bearish mood as the month went on.

Most of the asset classes were down during the month. Persistent economic growth and stickier inflation have dissolved hopes for interest rate cuts.

[2] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of June 1, 2023. 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.
[3] Source: Bloomberg Finance L.P. as of June 1, 2023.

I have been arguing for months in these pages that it was likely premature to expect interest rate cuts anytime soon. In light of this, we have maintained inflation-resilient and defensive positions in the model portfolios.

As the first section of this newsletter points out, the other factor that is elevating some parts of the market is the public's sudden fascination with anything related to artificial intelligence (AI).

Finally, as of this writing, there has been an agreement on the U.S. debt ceiling before the deadline. I didn't want to spend too much time over the last few months analyzing the issue as I thought this would be the likely outcome. Looks like I did myself a favour!

I expected a debt ceiling agreement, so no surprise there.

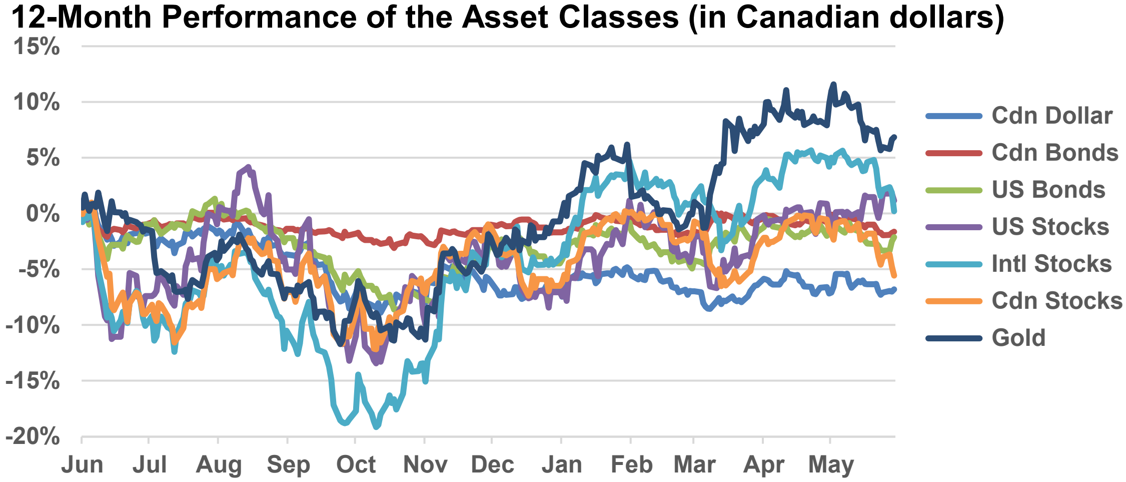
But, the debt ceiling agreement now means that the U.S. Treasury will be a very aggressive borrower, putting upward pressure on interest rates.

The debt ceiling agreement does come with a downside though. The U.S. Treasury has not been able to issue bonds or T-bills since January. Some estimates have them needing to raise $1 trillion by the end of September. How does one entice investors to soak up that amount of supply? By increasing the interest paid on those securities, which has the effect of raising the price of borrowing for everyone else. Whoops!

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 6**).[4]

Chart 6:

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



Source: Bloomberg Finance L.P. for the interval from May 31, 2022 to May 31, 2023

---

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

[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 | Senior Portfolio Manager & Senior Investment Advisor
Mike Elliott, BA, CIM®, FCSI® | Senior Portfolio Manager & Senior 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 June 1, 2023.

The information contained herein has been provided by Mark Jasayko, Senior Portfolio Manager and Senior 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.

Bloomberg and Bloomberg.com are trademarks and service marks of Bloomberg Finance L.P., a Delaware limited partnership, or its subsidiaries. All rights reserved.

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.

All trademarks are the property of their respective owners.

® The TD logo and other trademarks are the property of The Toronto-Dominion Bank and its subsidiaries.