TD Wealth

Private Investment Advice

The Charter Group Monthly Letter

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Economic & Market Update

B.C. Battle Royale[1]

Citizens vote with ballots.

Investors vote with their feet.

Investors vote with their feet. If they are dissatisfied, they walk away.[2] They don't have to uproot their family, sell a house and look for a new one, apply for work visas, adjust to new surroundings, or look for a new job in a new locale. If they aren't happy with a jurisdiction in which they have investments, they simply sell those investments and

[1] For me, the term "Battle Royale" conjures up teenage memories of watching a dozen professional wrestlers on TV battling simultaneously in the ring to determine the one eventual winner. It was so ridiculous that it was hard not to watch.

[2] This wouldn't apply in certain cases such as closed economies or economies with very strict capital controls. However, because of the hostility toward investors in these economies, it is unlikely that significant investor capital would have arrived in the first place.

move on with hardly skipping a beat. This allows the investment markets to behave as a perpetual barometer measuring investor sentiment with respect to various jurisdictions.

If outside investors don't like what they see, they take their investment capital elsewhere.

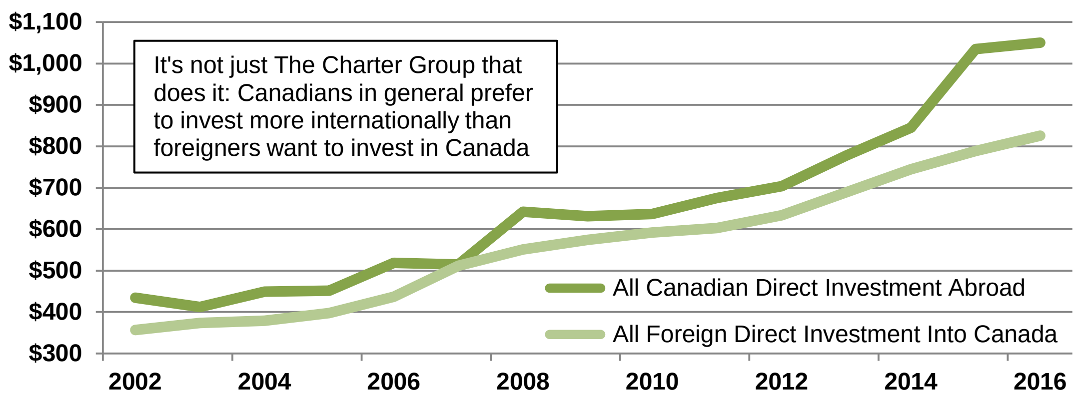
When deciding on whether to "vote" for a jurisdiction, investors look for things such as an educated workforce, infrastructure that facilitates the movement of people and goods with minimal hindrance, low taxes, low regulatory burdens, social stability, political stability, companies that trade at reasonable values, and policies and trends which support innovation in order to increase the probability of future growth.

There isn't a lot of patriotism when it comes to comes to managing investment portfolio risks.

At The Charter Group, our investment enthusiasm for B.C. has been tepid relative to other areas of Canada and elsewhere in the world. Our Balanced Portfolio currently has 1.88%[3] targeted to investments headquartered in B.C. (Telus & Canfor). That number would be slightly higher if we allocated our investments across Canada based on the population of each province. Also, as a contrast, we have 6.19%[4] targeted to companies that are headquartered in New York City alone. The bottom line is that we can dial up or dial down the B.C. exposure without much effort or cost.

Chart 1:

Total Foreign Direct Investment (in billions)



Source: Statistics Canada as of 6/5/2017

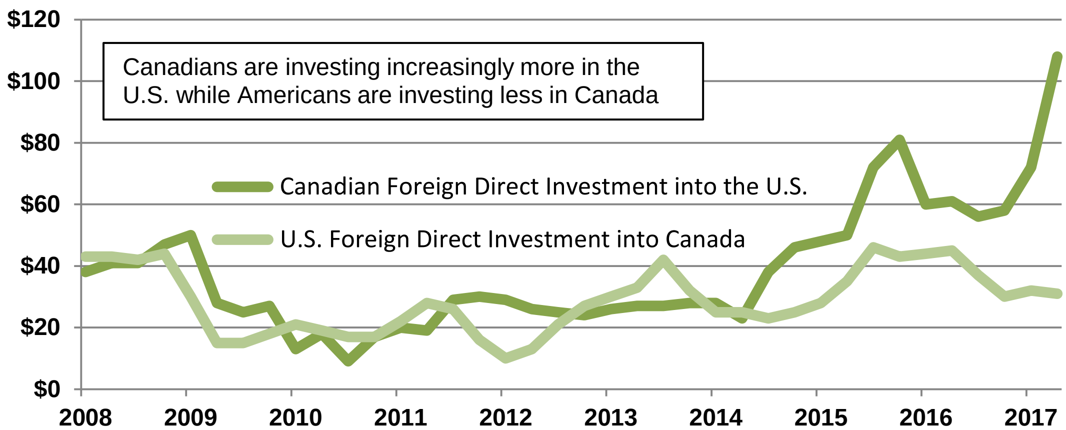
Sometimes there are factors which favour investing in domestic markets, but this can change if opportunities are not attractive enough.

The 1.88% invested directly in B.C. companies would likely be much lower to nil if it wasn't for the presence of some "home bias" in the Balanced Portfolio. The home bias is primarily the result of two things. Firstly, it is logistically easier to do research on a company if it is nearby. The familiarity potentially provides a degree of insight that investors from further afield would find more difficult to obtain. Secondly, our investors tend to have future liabilities denominated in Canadian dollars (future expenditures that

[3] As of 6/5/2017
[4] As of 6/5/2017

will take place in Canada). As a result, we have more investments denominated in Canadian dollars that would otherwise be the case (which increases our likelihood of investing in Canadian, as well as British Columbian, companies). However, it is

Chart 2:
Foreign Direct Investment (Four-quarter moving total in billions)



Source: Statistics Canada as of 6/5/2017

important to note that if investment opportunities in B.C. and Canada began to look less attractive, this would override the factors that create the home bias.

So, enough about the "daily election" that takes place in the investment markets. What about the recent B.C. provincial election and how might it affect investor capital flows?

An NDP/Green Coalition could have consequences for foreign capital invested in the B.C.

It could impact capital flowing into productive enterprises as well as into residential real estate.

The prospect of an informal coalition between the NDP and the Green Party introduces a number of factors that might impact investor enthusiasm for the province. That said, compared to other prominent destinations, it wasn't as though B.C. was a huge magnet for in-bound investment capital under the previous Liberal government.

Much of the capital that was flowing into B.C. was not invested into productive enterprises. Instead, it flowed into residential real estate that either provides utility as a place to live or as a store of wealth. There has been some chatter from the Coalition about doubling the foreign buyers tax which might be enough to quash the inflows enough to threaten the contribution that the real estate sector made to the overall economic growth of the province.

It is generally preferred that incoming capital gets invested into innovation, research, and value-added industries. Despite that, the capital that found its way into residential real estate was a positive factor in that it created revenue for the government as well as employment in real estate and the related spin-off industries. Foreign investors investing in B.C. businesses might want to see what the Coalition's Plan B is with respect to offsetting any adverse impact on government finances and overall employment.

Foreign investors might have a number of questions:

Will growth in infrastructure and energy delivery and keep pace with population and economic growth?

Will there be new costs and taxes?

How much political stability is there?

The other immediate focus is how the Coalition's policies will impact infrastructure, especially as it pertains to energy and transportation. Any eventual decisions will indicate to outside investors the trend of provincial regulatory burden and the government's willingness to facilitate the movement of people (especially commuters) and goods critical to business success.

Finally, it is not a surprise that a party whose name reflects its priority to environmental issues will want to elevate the importance of those issues. Occasionally there is some wishful thinking from advocates who argue that prioritizing environmental concerns is good for the economy. There might be some credence to the notion that it will spur on "green" technology and jobs. However, over the short- to medium-term, addressing these concerns often entails new taxes and other significant costs. Also, when contrasting those costs against the current trend in the U.S. of backing away from climate commitments, the economic consequences for B.C. multiply. If investors determine that the cost of doing business in the province is increasing, some are going to shift their investment dollars elsewhere.

Coalitions are often very frail which could trigger another election well before the end of the 4-year agreement signed by the NDP and the Green Party. A number of disruptive possibilities include a battle of egos, disagreements over policies, or a falling approval rating of one Coalition parties. This injects a huge dose of uncertainty into the B.C. political landscape with respect another possible election and whether the Liberals will have a new leader and policy platform by then. Any degree of political uncertainty is negative to investors when deciding where to invest.

Taking foreign investment capital for granted could be the biggest risk of all.

As mentioned in previous editions of *The Charter Group Monthly Letter*, an ideal economic strategy would involve doing the hard things necessary to compete with the technology hotbeds around the world. Beyond some cheap campaign rhetoric all around, there hasn't been any progress on this front from any of the party leaders. As a result, we are only left with the benefits provided by continued low interest rates which fuels much of the real estate growth and allows governments to spend without immediate concern over the debt burden. However, if rates rise, taking foreign capital for granted could reveal itself to be one of the biggest risks of all.

Model Portfolio Update[5]

The Charter Group Balanced Portfolio
(A Pension-Style Portfolio)

	Target Allocation %	Change
Equities:		
Canadian Equities	15.0	None
U.S. Equities	35.7	None
International Equities	9.3	None
Fixed Income:		
Canadian Bonds	25.5	None
U.S. Bonds	2.5	None
Alternative Investments:		
Gold	7.5	None
Commodities & Agriculture	2.5	None
Cash	2	None

No changes were made to the Balanced Portfolio during May.

A stronger Canadian dollar and flat U.S. stock market were the main detractors from the results for the month.

No changes were made to the individual investments or the overall asset allocation in The Charter Group Balanced Portfolio during May.

A slightly higher Canadian dollar over the month detracted from the returns on already sluggishly performing U.S. stocks.

The Canadian dollar was higher primarily because of a weaker U.S. dollar compared to most international currencies. As the odds of two more short-term rate hikes in the U.S. before the end of the year have deteriorated, currency traders started to sell the U.S. dollar (higher short-term rates attract yield-seeking foreign investors, and visa-versa).

During the middle of the month, the drama in U.S. politics finally had a noticeable effect on stocks, sending them down by almost two percent. However, investor anxiety surrounding this was short-lived and within a week markets had recovered from the selloff.

[5] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 5/5/2017. The asset allocations of individual clients invested in this Portfolio will 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.

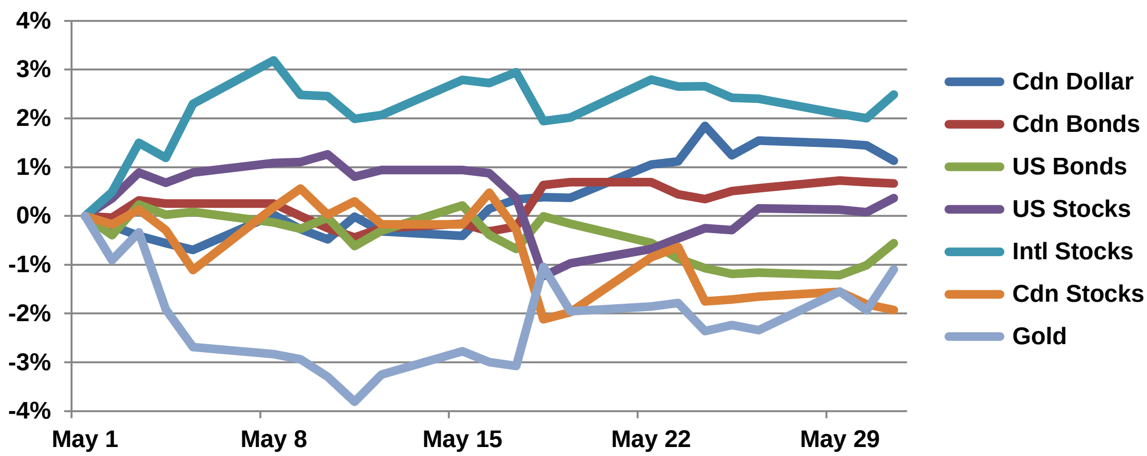
The current investment narrative, which began with the election of President Trump, remains mostly intact. Basically, it is the hope that pro-market and pro-growth policies will eventually be passed and enacted. Although getting Congress to agree on the policies has turned out to be much slower than President Trump anticipated, most of his initiatives still have some life to them. The markets would probably wait until there are signs that the proposed policies are truly dead in the water before selling off.

Investors are still waiting with hope to see if Trump's pro-market and pro-growth policies will be passed and enacted.

Below is the May 2017 performance of the asset classes that we use in the construction of The Charter Group Balanced Portfolio (**Chart 3**).[6]

Chart 3:

May 2017 Performance of the Asset Classes (In Canadian dollars)



Source: Bloomberg Finance L.P. as of 6/5/2017

[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 iShares Canadian Universe Bond Index (XBB); U.S. bonds are represented by the iShares Core U.S. Aggregate Bond Index (AGG); U.S. stocks are represented by the iShares Core S&P 500 Index (IVV); International stocks are represented by the iShares MSCI EAFE Index (EFA); Canadian stocks are represented by the iShares S&P/TSX 60 Index (XIU); Gold is represented by the iShares Gold Trust (IAU).

Top Investment Issues[7]

Issue	Importance	Potential Impact
1. China's Economic Growth	Significant	Negative
2. Canadian Dollar Decline	Moderate	Positive
3. Long-term U.S. Interest Rates	Moderate	Negative
4. U.S. Fiscal Spending Stimulus	Moderate	Positive
5. Canada's Economic Growth (Oil)	Moderate	Negative
6. East Asian Geopolitics	Medium	Negative
7. Massive Stimulus in China	Medium	Positive
8. Short-term U.S. Interest Rates	Light	Negative
9. Japan's Money Printing	Light	Positive
10. Europe's Money Printing	Light	Positive

[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, we encourage you to email mark.jasayko@td.com and set up a time to talk face-to-face or by phone.

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The Charter Group at TD Wealth Private Investment Advice 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 5, 2017.

The information contained herein has been provided by Mark Jasayko, Portfolio Manager and Investment Advisor and is for information purposes only. The information has been drawn from sources believed to be reliable. Where statements are based in whole or in part on information provided by third parties, they are not guaranteed to be accurate or complete. 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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