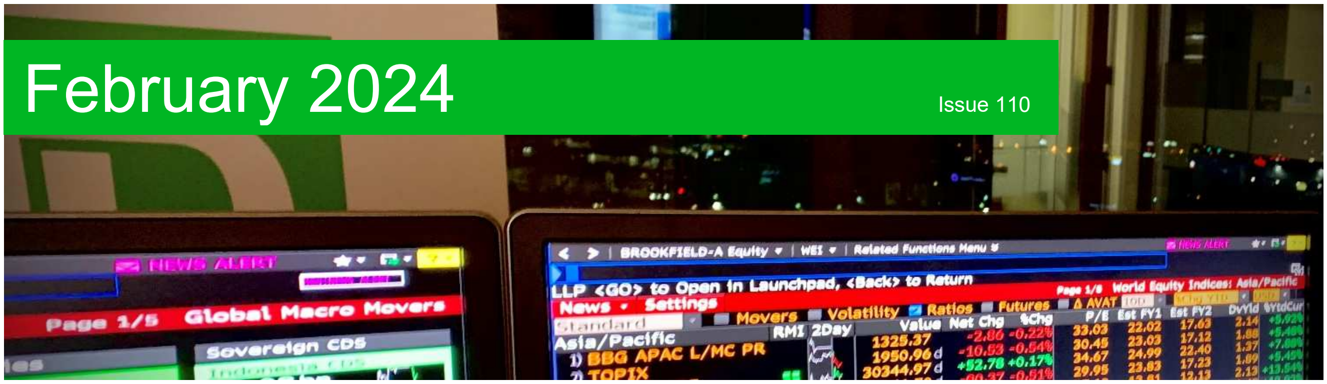
The Charter Group Monthly Letter



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Economic & Market Update

The Land of 211% Inflation

January saw your portfolio manager travelling around Argentina. In addition to the scenery (mountains & coastlines) and the food (primarily steak & lamb), I was looking forward to visiting, for the first time, a country in the midst of hyperinflation.

A trip to Argentina allowed me to witness firsthand the impact of extremely high levels of inflation.

I didn't see anyone pushing wheelbarrows full of money to the store, or banknotes denominated in the millions,[1] but I did get plenty of colourful responses from those whom I asked about the difficulties of dealing with the situation.

The business owners I talked with tended to increase the prices of the goods or services that they sold about once a month. The challenge is to gauge how high the price can be raised without seriously risking a drop in customer demand. They also mentioned uncertainties with respect to how high the costs of labour, material, and services would

[1] The most common denomination was the 1,000 Argentinian peso banknote, which was worth about $1.20 in US dollars, or about $1.63 in Canadian dollars, while I was there.

rise during the month. If those costs can't be kept in line with the price of what they are selling, profit margins will take an immediate hit.

With respect to labour, there is plenty of unrest stemming from a concern of wages not keeping pace with the rate of inflation. While I was there, a one-day national strike was called, which stranded me in Buenos Aires for an extra night as all flights in the country were grounded.[2]

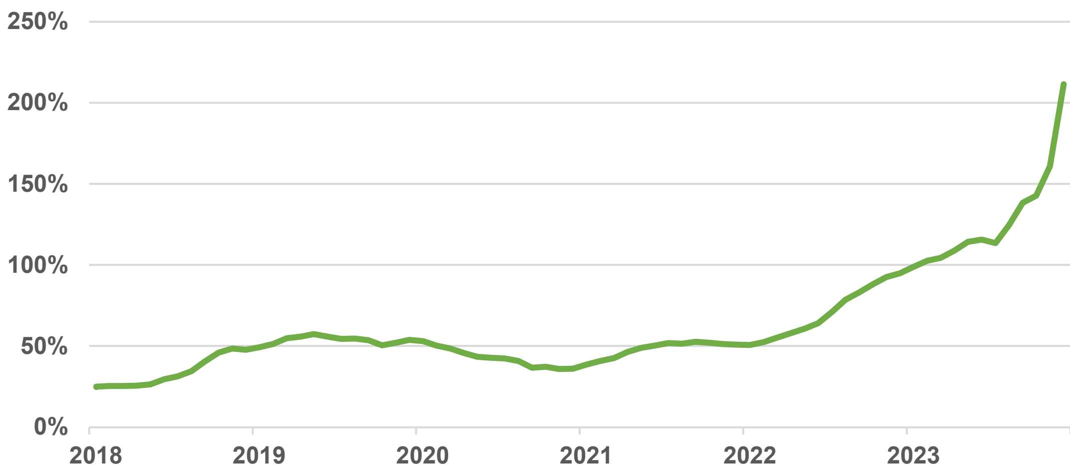
For me, as a visitor, I still had to pay global prices for things like domestic airfare and hotels. These specific services are influenced by tourists who have the money to spend. However, for basics, like food, I was paying prices that were closer to what Argentines would expect to pay. For example, a Big Mac Meal in Buenos Aires showed up as $6.67 in Canadian dollars on my credit card statement. In Vancouver a few weeks before the trip, the same Big Mac Meal showed up as $12.13 on the statement.

So, how did Argentina end up with 211% inflation? (**Chart 1**) If one listens to many modern economists as to what causes inflation, most might say that it is an excess demand for goods and services. Overheated economic growth would increase the gap between demand and supply. I would contend that such a factor was what had pushed up prices in North America, albeit slowly, over the last four decades. But, Argentina is not dealing with an overheated economy (**Chart 2**), or an output gap.

Businesses had difficulty managing costs and challenges in setting prices so as to not destroy customer demand.

Workers were also angry, resulting in a one-day national strike where the whole country was effectively shut down.

Chart 1:
Argentina Annual Inflation Rate (CPI)

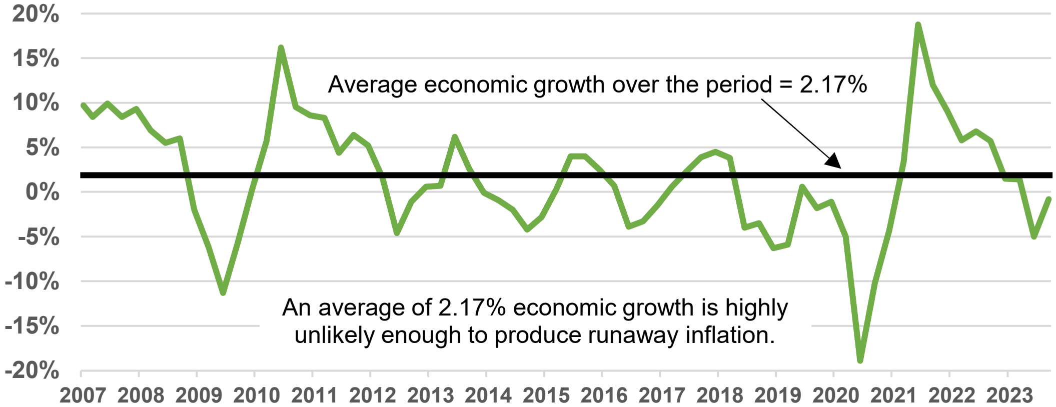


Source: Bloomberg Finance L.P. as of February 1, 2024

[2] I was scheduled to fly from Buenos Aires to Ushuaia located in the Province of Tierra del Fuego, at the southern tip of the continent. I eventually got there, but the itinerary for the remainder of the trip became very rushed as a result.

Chart 2:

Argentina Annual Annual Economic Growth Rate (GDP)



Source: Bloomberg Finance L.P. as of February 1, 2024

Also, in the last few years, it has become popular to blame the spike in North American prices on supply glitches during the post-Pandemic period as demand raced out ahead of the ability of businesses to provide goods and services. There is credibility to this argument in the case of North America, but again, it does not explain an inflation rate of over 200% in the case of Argentina.

Many of the fashionable and recent theories for what causes inflation don't apply to Argentina.

If the fashionable explanations don't apply, then focus might need to turn to Argentina's struggle to reign in government spending, resulting on a dependence upon loans from the International Monetary Fund, and, eventually, a default on most of those loans. And, if one is no longer able to borrow to finance the spending that much of the population is expecting, then there might be the temptation to print pesos to cover the difference.

This more classical argument for the cause of inflation is likely the answer. Expanding the money supply by printing banknotes creates a situation where there is too much money chasing a relatively fixed aggregate supply (all the goods and services produced by the country). Business owners and workers are able to figure this out quickly and engage in behaviors that aim a protecting themselves while also further contributing to inflationary forces.

Instead, it is the more classic cause of inflation: spending too much and printing money.

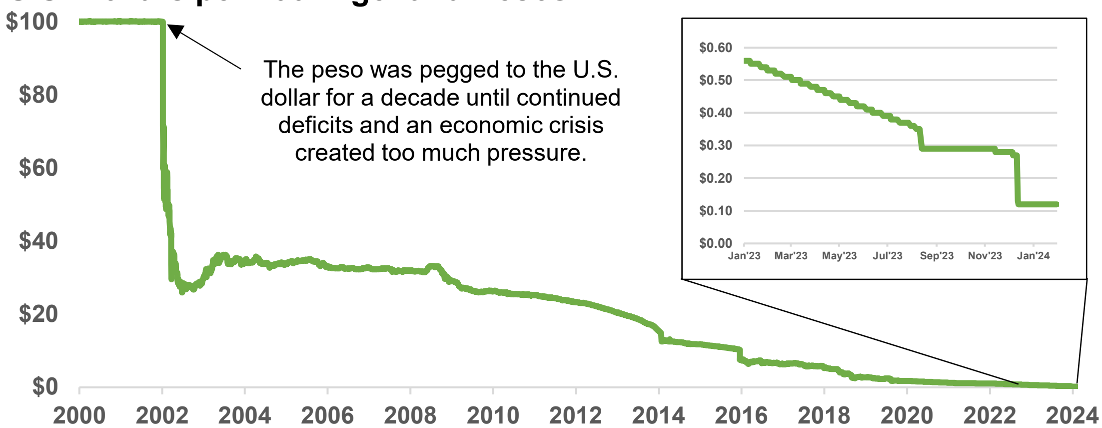
This isn't a new problem for Argentina. Although the country was one of the remarkable economic success stories through to the Great Depression of the 1930s, it was never able to industrialize to the extent that we saw elsewhere in the developed world (much of this was the result of misguided economic policies). This relative stagnation has continued through to today and the economy can't generate the needed tax revenues.

There has been some recent political change and promises of spending cuts (which precipitated the national strike while I was there). Also, there is talk of replacing the circulation of Argentine pesos with U.S. dollars. In small countries with more simple economies, there has been some success with such a scheme. However, in larger countries with so many competing internal interests, this kind of arrangement can be too disruptive. When I visited back in 2000, the peso was pegged 1:1 to the U.S. dollar, which is similar to just using U.S. dollars. However, that was abandoned. Whereas 100 pesos could be exchanged for 100 dollars back then, they only receive 12 cents now! (**Chart 3**).

There has been some recent radical policies implemented to fight inflation, but Argentina's history suggests that this may not have the desired long-term effect.

Chart 3:

U.S. Dollars per 100 Argentina Pesos



Source: Bloomberg Finance L.P. as of February 1, 2024

The gravitational pull of populist and reckless fiscal policies in Argentina will be hard to overcome. History has shown us this with the defaults of its sovereign bonds occurring in 1827, 1890, 1951, 1956, 1982, 1989, 2001, 2014, and 2020.[3]

Outside of Argentina, populist-driven excessive spending has caught on in the developed world, including the U.S. and Canada. Myopic focus on supply chain issues and hot-running economies may obscure the importance of fiscal prudence. The risk with leaders from all across the political spectrum advocating never-ending deficit spending is that we might eventually get a taste of what Argentina is experiencing: interest rates that are higher than what we have been used to over the past three decades along with a dose of inflation angst.

In Canada and the U.S., accelerating government spending, despite a decent economy, could risk entrenching some of the economic hurdles that Argentina has dealt with for years.

[3] In 2017, Argentina managed to issue a 100-year bond (imitating a few other countries at the time). Somewhat comically, that bond defaulted 3 years into its century-long journey. It's like the image of Lucy pulling away the football while Charlie Brown is in mid-kick, yet again.

Model Portfolio Update[4]

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 in the model portfolios remained unchanged in December. However, a number of positions were removed.

No changes to the asset allocations. But, some of the investments in the model portfolios were sold.

We sold CN Rail after holding it for about 10 years. The position was up 180% over the holding period (with dividends reinvested, total return was about 215%). We had considered selling it at a number of points over the last two years as the gains from the multi-decade application of "precision railroading" techniques had been fully realized.

CN Rail was sold after holding it for about 10 years.

We also removed the U.K. and Germany country ETFs. In both cases, we were not encouraged by recent economic policy plans in the context of a more challenging environment with respect to persistent inflation in Europe and a brewing trade battle with China.

The exposure to the U.K. and Germany was removed because of ineffective policies in the face of a changing economic realities.

From a portfolio perspective, we were slightly above the number of positions needed to achieve the most efficient level of diversification. Those positions removed were not going

[4] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of February 1, 2024. 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.

to contribute to a reduction in portfolio volatility. As a result, if they were not going to add much to return in our view, it was time to do some pruning.

Over the month it was the U.S. equities that added the most to the portfolio results. There is still considerable investor optimism in the U.S. despite some warning signals beginning to flash regarding potential overvaluation. We don't tend to be invested in those overvalued parts of the market, so our exposure may be limited. However, if earnings are more anemic than expected, and if investors don't get the interest rate cuts they want, there is a chance of a selloff which would create some headwinds for the model portfolios over the next few months.

U.S. stocks had the most positive impact on the portfolio results during January. But, the U.S. market could be getting overvalued.

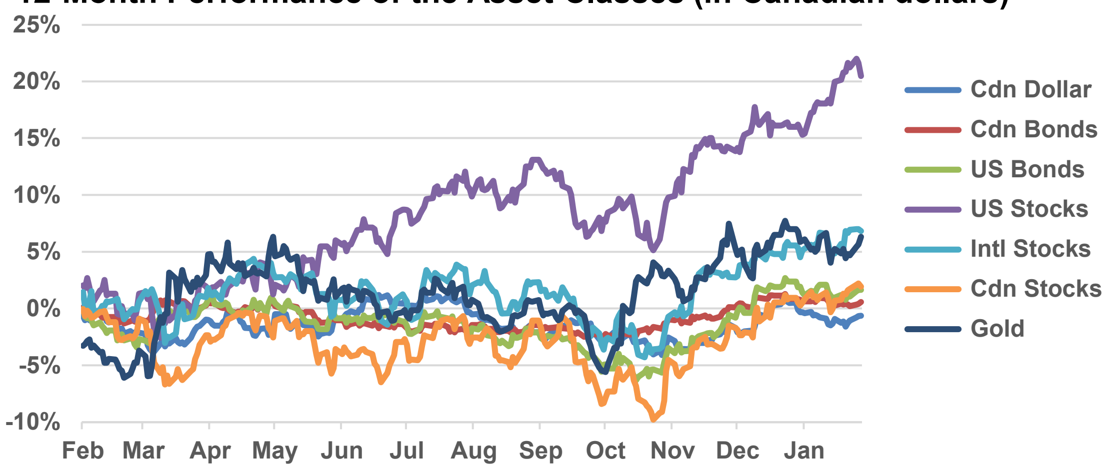
Otherwise, the rest of the asset classes that we use in the model portfolios were relatively quiet for the month and could remain such until there is a catalyst to move them one way or the other. Negative catalysts might involve a further delay in interest rate cuts, a geopolitical crisis, or a worsening economy (although this might be offset since it could accelerate interest rate cuts). A positive catalyst would be if inflation started to race back to the 2% target set by central banks. However, that scenario needs many things to go right and not much to go wrong. Therefore, I would hesitate to place a high probability on this.

The rest of the asset classes had a docile month. They may be in a holding pattern until we get more economic news or a geopolitical event.

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**).[5]

Chart 4:

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



Source: Bloomberg Finance L.P. for the interval from Febuary 1, 2023 to January 31, 2024

[5] 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[6]

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

[6] 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 February 1, 2024.

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.

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TD Wealth Private Investment Advice

Thank you from The Charter Group at TD Wealth

Thank you to our clients and community for voting The Charter Group, your favorite for Investment Management and Financial Planning in Langley for the fourth year in a row.

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