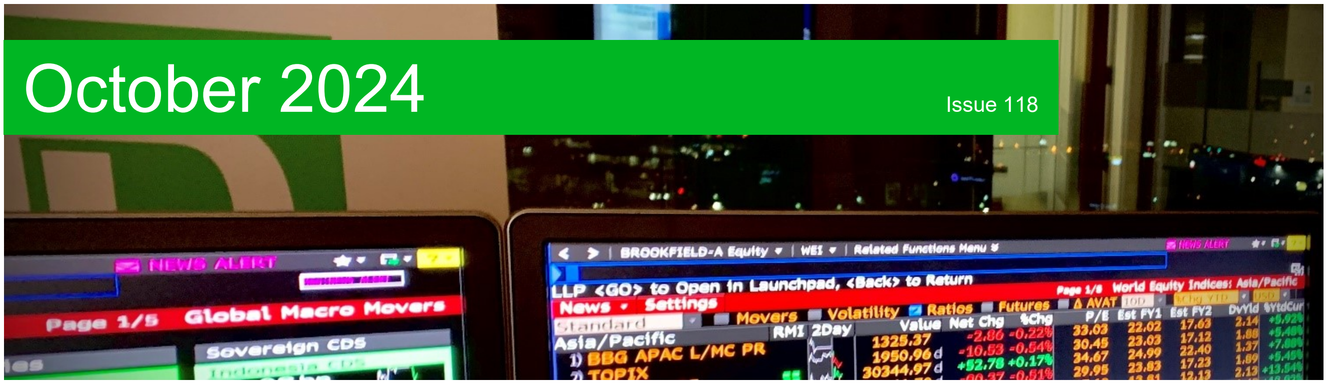
The Charter Group Monthly Letter

October 2024

Issue 118



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Economic & Market Update

Bull in a China Shop

A number of investors are thrilled that the government in China has promised to stimulate the economy.

But, is fixing the economy really that simple?

Over the last few weeks of September, the Peoples Republic of China announced a number of stimulus measures on the hopes that this will right their economic ship.

Despite a cacophony of economic commentators from around the world howling for stimulus over the past year to counter a lack of consumer spending in China, the government there has resisted taking action. Perhaps it was the news of the recent Federal Reserve rate cut in the U.S. that finally pushed them.

The Peoples Bank of China (the PBOC) announced a number of cuts in various policy interest rates. However, the excitement really got rolling when the government suggested that they were about to juice the economy by doling out about $285 billion USD to consumers and spending about $114 billion to prop up stocks that trade in China. Otherwise, the details are vague. Maybe mostly empty promises hoping that the general message will be enough to reignite "animal spirits."

Why has the government waited so long? Over the years there has been an expressed reluctance from the Politburo to engage in social spending which is often communicated by stressing the importance of things like personal struggle and resilience. Unlike developed economies that are driven mostly by consumer spending, China's economy is driven by government spending and subsidized investment spending. This is common for emerging economies. Industrial policy directed by the government often provides the fastest route for development. Also, establishing social and welfare benefits is very expensive and can often only be financed by countries that have achieved economic maturity. Another concern is that people will have more time to participate in things other than working and saving. Progress can slow down significantly when consumers start to play a larger role in influencing policymaking and by participating in approval processes. In North America, civic engagement can delay or block economically vital projects.

China is dealing with numerous deep-rooted economic problems that may require bold and politically risky reforms.

Over the last two decades leaders there have tended to shy away from big policy promises.

This is my quick summary of recent events:

1. China's economy is suffering from the economic distortions caused by their prolonged COVID lockdown. Main result is reduced consumer confidence.
2. Consumers who are worried about a lack of social safety net will save instead of spend, leading to reduced economic growth and some price deflation.
3. Very poor demographics, a massive debt overhang, a stagnant real estate market plagued by oversupply, and heavy-handed policies that have shut down or impaired a number aspects of the private sector are all laid on top of the lack on consumer confidence emanating from the lockdown.
4. The government tried to counter this by supporting export manufacturers (EVs, batteries & solar panels). But, this wasn't helping to improve economic growth.
5. The U.S. Federal Reserve cuts rates despite the U.S. economy doing pretty well. This increased the contrast against China's dismal economy and forced the authorities there to act.
6. The announcements are difficult to assess in terms of impact and magnitude.
7. Hard to assess how much conviction the government has.
8. Investors who were already bullish on China didn't care about the details and sent shares soaring.

Despite that, a contingent of investors is wildly bullish on recent stimulus announcements.

A prominent hedge fund billionaire appeared CNBC (the American financial TV channel) on September 26th and declared that he was buying 'everything' related to China.[1]
I was in New York at a conference on October 1st which featured an equally prominent

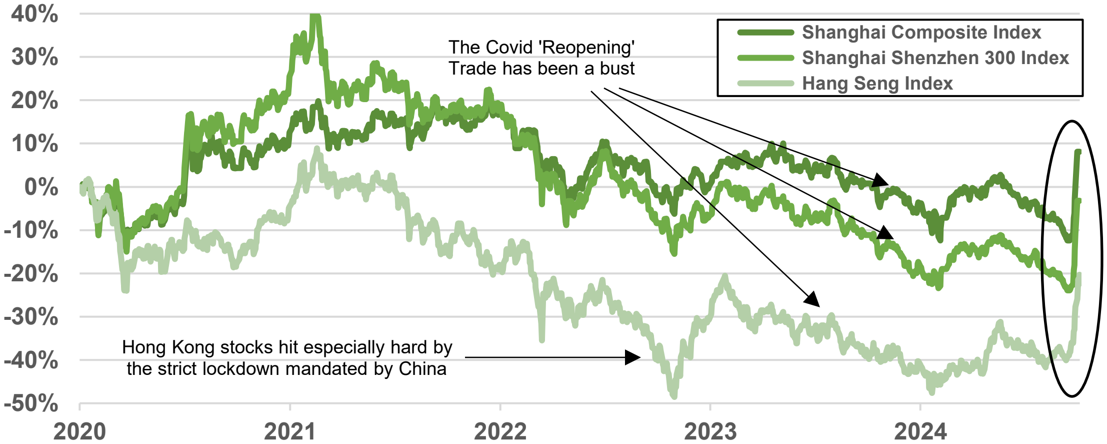
[1] Sarah Min, "David Tepper's big bet after the Fed rate cut was to buy 'everything' related to China." CNBC, September 26, 2024.

hedge fund billionaire (who had made investments in China in the past) who said he was avoiding China completely for the foreseeable future despite the stimulus announcements.[2] [3] So, clearly, there is not a consensus on what to do with respect to investing in China.

However, on the other side of the discussion there is a sizable contingent of investors who are not taking the bait.

Chart 1:

Chinese Stocks - Since 2020



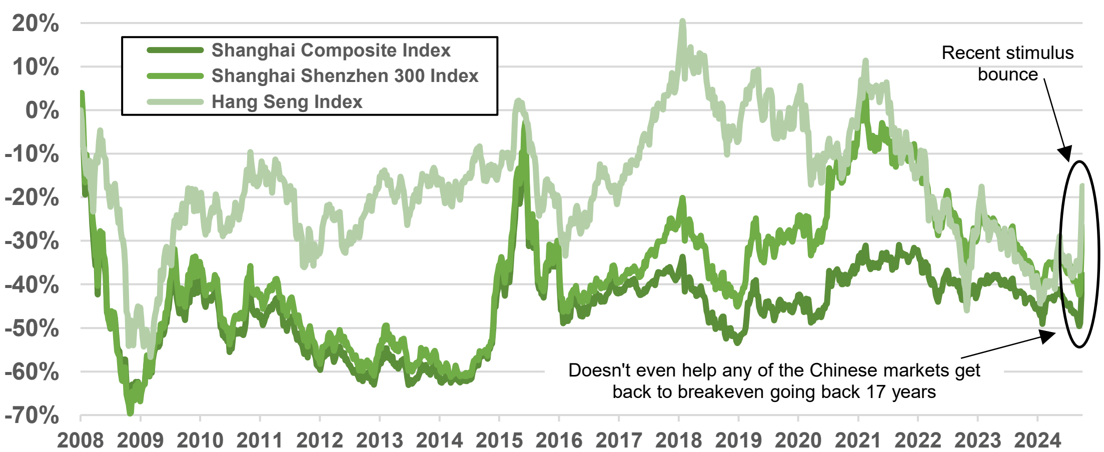
Source: Bloomberg Finance L.P. as of October 7, 2024

That said, the market gains have been eye-popping (**Charts 1&2**). I have a sense that there was growing number of investors who just needed a signal to jump in, and they saw one. Also, the aforementioned $114 billion USD that the government earmarked for buying stocks might have helped as well.

After some initial stock market gains in China, we may have to wait a while to see who wins this tug-o-war.

Chart 2:

Chinese Stocks - Since 2008: Going Nowhere After 17 Years



Source: Bloomberg Finance L.P. as of October 7, 2024

[2] Stanley Druckenmiller in conversation with James Grant at the Grant's Annual Fall Conference, New York, NY, October 1, 2024.

[3] Karishma Vanjani, "This Hedge Fund Legend Isn't Buying the China Rally." *Barron's*, October 1, 2024.

I've have had no client assets allocated to China since 2007. The recent news hasn't changed my mind. I personally think that the market there is 'tradable' but 'uninvestable.' And, since I am an 'investor', it is not possible for me to rationalize a return to China until there are more reforms that address the concerns of investors who are risking capital.

I haven't invested in China since 2007.

And, it doesn't look like I will anytime soon.

Going forward, my skepticism leads me to think that the stimulus will lead to a short-to-medium upward bump in Chinese stocks. However, I think that it is a stretch to view the measures as a magic bullet that will turn the Chinese economic ship around. Many of the challenges, such as demographics and a loss of competitiveness because of rising wage costs extend much further back that the pandemic or the more recent real estate rut.

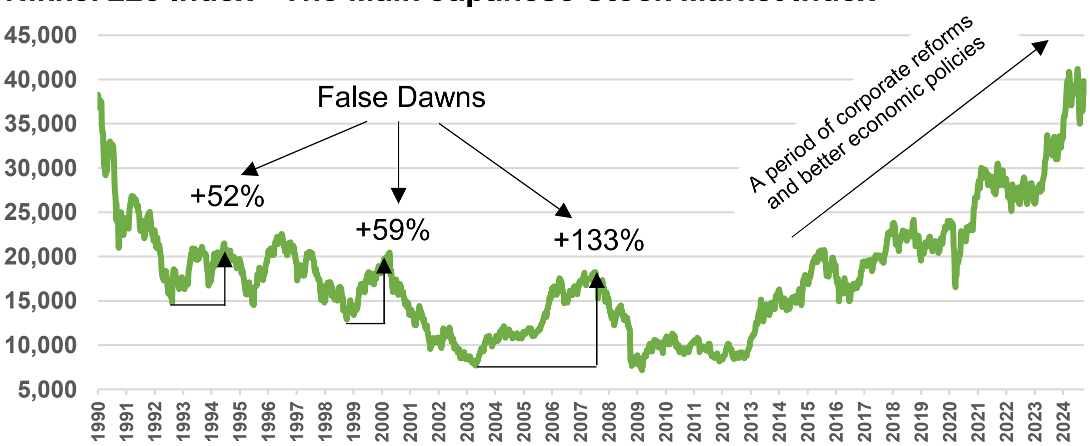
In fact, barring a whole-of-nation level of changes, the challenges may persist indefinitely.

In terms of demographics, real estate, and lost consumer confidence, Japan faced similar dilemmas back in the 1990s. There were a number of false dawns there as investors seized on announcements that sounded like remedies only to witness half-hearted implementations or minimal impact even if implemented properly (**Chart 3**).

Some of the problems that plagued Japan in the 1990s and then persisted for the next decade may be instructive for China.

Chart 3:

Nikkei 225 Index - The Main Japanese Stock Market Index



Source: Bloomberg Finance L.P. as of October 7, 2024

The lesson might be that in lieu of very bold and transformative reforms, it may take a very long time for the Chinese economy to return back to prosperity of the last two decades.

Although there are differences in the details, 1990s Japan is probably the best template that we have for Chinese stocks at the current time. I wouldn't be surprised if Chinese stocks saw repeated false dawns following a stream of announcements over the next few years. This could be an extended process. Although modern investors are vastly more informed than previous generations, it often still takes them a long time to let go of hope and to look at the underlying data with an unbiased perspective.

This may not bode well for the Chinese stock market enthusiasts.

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

No changes in the model portfolios during September.

No changes were made to the asset allocations and the securities in the model portfolios during September.

Gold continues to be a notable positive contributor to results.

Gold bullion was again the star performer following up its 2% gain in August with a 5% gain in September (all in Canadian dollar terms). It was hoped that the Federal Reserve half percent rate cut would reduce the attractiveness of U.S. Treasury bonds on a yield basis relative to gold (if government bonds pay less interest, then, the thinking goes, gold, which does pay any interest, looks better). Also, lower interest rates run the risk of reigniting inflation, in which case gold looks good as a hedge.

Equity investors drove prices higher on the news of Federal Reserve interest rate cuts.

Equity investors were also doing their best to conjure all sorts of 'Goldilocks' scenarios where, somehow, we get robust economic growth without inflation. This might explain some of the giddiness in stocks where we saw the S&P 500 Index in the U.S. rise 5.4% and the S&P/TSX in Canada rise 4.2%.

[4] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of October 7, 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.

And, bonds were generally positive for the month regardless if they were U.S., Canadian, or international bonds. Central banks promising to take an axe to policy interest rates will usually have this effect!

Last month I wrote how September has been the worst month for stocks going back over a century. Well, this September turned out to be the first positive one since 2019 😊. From 2020 through to last year, the September results were -3.92%, -4.76%, -9.36% & -4.78% for the S&P 500. As it turns out, October is the 2nd worst month for stocks since 1896, so markets may be vulnerable to any uncertainty related to the U.S. Presidential election on November 5th.

September's positive gains defied its notoriety as being the worst month historically for stocks.

But, that may not help things in October with potential uncertainty surrounding the November U.S. Presidential election.

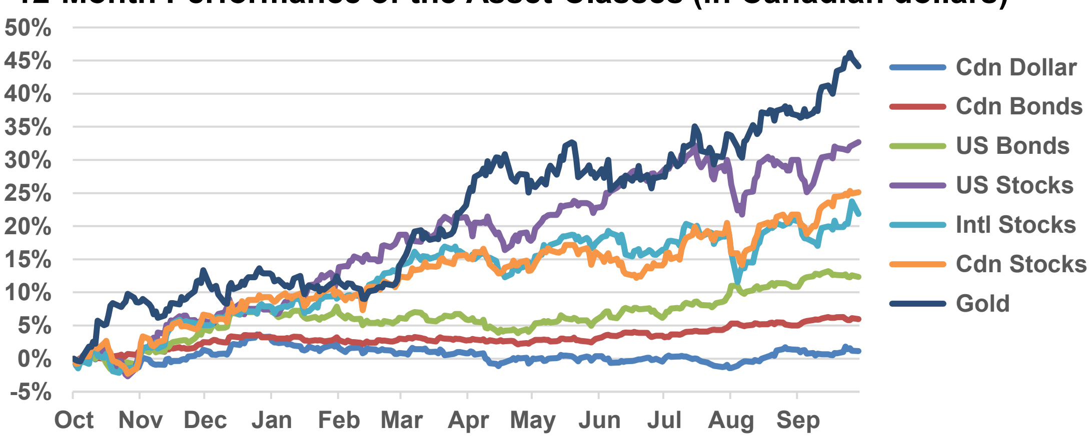
Apart from election uncertainty, the real focus of investors may be on the probability for more interest rate cuts. Investors have high expectations. However, the labour market is proving to be stubbornly strong and there is an outside chance that a dramatic escalation of battles in the Middle East will revive oil prices from their slumber (any targeting of Iranian oil infrastructure would likely do this). Not good from an inflation perspective. However, the model portfolios still have a number of inflation hedges in place which may provide some protection this kind of scenario.

Inflation is still bubbling here and there and may disappoint investors if it slows down the expected pace of interest rate cuts.

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 October 1, 2023 to September 30, 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 October 7, 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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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 fifth year in a row.

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